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July 2008

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## CAMPAIGN CONTRIBUTIONS AND FIRM PERFORMANCE: THE 'LATVIAN WAY'

This paper examines the effect of campaign contributions on firm performance in Latvia, using a quasi-experiment provided by the 2002 elections. An unanticipated result of the election was that the 'Latvian Way', one of the most influential parties, failed to be re-elected and was replaced by the 'First Party'. It constructs a unique dataset of firm-level campaign contributions by identifying all firms that donated directly or through its board member or shareholder. This paper finds that firms that provided contributions to the 'Latvian Way' experienced substantial decrease in sales in the after-election year, compared to firms that did not contribute. In contrast, firms that contributed to the 'First Party' experienced significant increase in sales. These findings suggest campaign contributions help firms benefit from firm-specific political favors.

## 1. Introduction

What exactly is the role of campaign contributions? A popular view among economists is that special interest groups use contributions to buy policy favors (Becker, 1983; Grossman and Helpman, 1996). Empirical evidence, however, is mixed. Generally, the literature has found it difficult to tackle the issue of endogeneity of campaign contributions (Ansolabehere, de Figueiredo, and Snyder, 2003). Another issue is that campaign contributions might be endogenous to whether they are observable to the public. If special interest groups know that campaign financing is subject to public scrutiny, they may conceal their contributions by using third parties or by helping politicians in more subtle ways.<sup>2</sup>

This paper contributes to the literature by making three methodological innovations. First, it uses unique firm-level data to study the effect of an unanticipated shift of political power on firm performance in Latvia, a young democracy in Eastern Europe. In October 2002 elections, the *Latvian Way*, one of the country's most influential political parties, failed to get re-elected by falling just 0.1 percent short of the 5 percent election threshold. Departure of the Latvian Way was a surprise to its donors because the polls predicted strong performance throughout most of the election period. The unexpectedness of the Latvian Way's departure makes it a nearly ideal way to measure how much politicians can affect firms. Second, this paper uses a comprehensive dataset on campaign contributions that was not publicly available during the election period.<sup>3</sup> Furthermore, to ensure a more comprehensive coverage of contributions by business interests, it uses Business Registry data to identify all firms that contributed through their significant shareholders or board members. Third, in contrast to previous studies that focus on publicly-listed firms, this paper draws on the universe of all registered firms. In addition, panel nature of the data allows using firm fixed effects to control for unobserved heterogeneity within the same firm over time.

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<sup>2</sup> For example, Bertrand et al (2006) show that French firms managed by politically connected CEOs help reelect incumbent politicians by accelerating rates of job and plant creation in election years.

<sup>3</sup> Data on campaign contributions were collected by the anti-corruption agency (KNAB), which was only established in October 2002. The data were only made publicly available after the elections.

There is another good reason that makes Latvia interesting to study the impact of campaign contributions. The value of political connections in Latvia is likely to be greater than in more developed countries because it is a transition economy with relatively weak democratic institutions. As a percentage of GDP, the total amount spent in the 2002 election in Latvia was about twice what was spent in the 2004 Presidential elections in U.S.<sup>4</sup> There is also substantial survey-based evidence of rent-seeking and corruption. *Transparency International*, an international corruption watchdog, has consistently ranked Latvia as one of the most corrupt countries in Europe.<sup>5</sup> Latvia was also characterized as a “high-capture” economy in World Bank’s Business Environment and Enterprise Performance Survey’s (BEEPS) ranking of “state capture” by special interest groups in 22 transition countries in 1999. 35 percent of surveyed firms reported being affected by “contributions by private interests to political parties and election campaigns” (Hellman, Jones, and Kaufmann, 2000).

This paper uses difference-in-difference method to analyze the impact of Latvian Way’s departure on sales of connected firms before and after the 2002 elections. Data on campaign contributions are merged with the Business Registry to assemble a unique dataset of 844 firms that made significant campaign contributions. Of these, 188 firms registered corporate contributions, and the rest contributed through a board member or a significant shareholder. Each contributing firm is matched to a non-contributing firm of similar size and in the same industry to create a control group.

I find that politicians have a significant impact on Latvian firms. The departure of the Latvian Way caused a firm that donated 8,000 LVL ( $\approx$ \$16,000, which was the average in the sample) to this party in the previous election cycle to lose 18.4% of its gross sales in the year following the election. In contrast, a firm that donated 8,000 LVL to the *First Party*, a rival of Latvian Way and one of the biggest (and also unexpected) winners of the 2002 election, increased sales by 21.5%. The point estimates are consistent with the coefficients being equal and opposite.

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<sup>4</sup> The total amount spent in the 2002 election cycle (January 1 to October 5) was 3.6 million Latvian lats (1LVL  $\approx$  2\$). For comparison, across all U.S. elections in 2004, the grand total spent is estimated to be about \$4 billion (Stratmann, 2005, p. 135).

<sup>5</sup> On a scale 0 to 10 (10 being least corrupt), Latvia achieved a score of 4.7 in 2006, putting it in the same group with South Africa, Tunisia, and Dominica. This was an improvement as compared with 2000, when it scored 3.4 points.

This paper is related to two strands of literature. First are studies of the effect of campaign contributions on policy outcomes. Grossman and Helpman (2001) provide a thorough theoretical treatment of the issues. Empirically, most studies focus on the effect of contributions on voting by members of U.S. legislature.<sup>6</sup> However, there is little consensus in this literature. Some scholars view campaign contributions as investments in political marketplace, on which a rate of return is expected (e.g. Stratmann, 1998; Kroszner and Stratmann, 1998). A competing explanation promoted by, among others, Ansolabehere, de Figueiredo, and Snyder (2003) is that donors contribute to get their preferred candidate elected, implying that campaign contributions should be viewed as a form of consumption, rather than investment.

Second, there is a growing literature that uses micro-level datasets to study the effects of rent-seeking on firm-level outcomes (see, for example, Fisman, 2001; Faccio, 2006; Khwaja and Mian, 2005; Faccio, Masulis, and McConnell, 2006; Claessens, Feijen, and Laeven, 2006). These studies proxy rent-seeking by “political connections”, typically defined as having a politician on a firm’s board, or among shareholders, or making a campaign contribution. Most closely related to this paper are studies by Jayachandran (2006) and Goldman, Rocholl, and So (2006) who show how companies’ value is affected by changes in the strength of political connection. In particular, Jayachandran (2006) uses the surprise event when Senator Jim Jeffords left the Republican Party and tipped control of the U.S. Senate to the Democrats. She demonstrates that the ‘Jeffords effect’ resulted in loss of market value for firms that made significant ‘soft-money’ contributions to the Republican Party. Similarly, Goldman, Rocholl, and So (2006) employ the fact that the 2000 Presidential election was a close race between Bush and Gore. They show that in response to the Republican win in the election the stock of S&P500 companies connected to the Republican Party increase in value, while companies connected to the Democratic Party decrease in value. However, both of the above studies use data on publicly-listed firms, whereas this paper uses data on all firms in Latvia. Also, in both cases the companies were well aware that their contributions may be subject of public scrutiny. In Latvia, however, data on campaign contributions were

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<sup>6</sup> Mueller (2003) provides a comprehensive survey of this literature.

made publicly available only after 2002 election and for the first time in country's history.

The rest of the paper is organized as follows. The next section describes the Latvian political system and the outcome of the 2002 election. Section 3 outlines hypotheses, measurement, and econometric methodology. Section 4 describes the data. Section 5 provides a discussion of the results. Section 6 concludes.

## 2. Political system, 2002 elections, and campaign financing in Latvia

In this section, I give a brief overview of the electoral system in Latvia and the institutional setup for campaign contributions. I also describe the special role played by the "Latvian Way" party and the outcome of the 2002 election.

Latvia is one of transition's success stories: an ex-Soviet republic, it joined European Union in 2004 and is now one of Europe's fastest growing economies. Unlike the United States, it is a parliamentary republic with executive power concentrated in the Cabinet of Ministers, headed by the Prime Minister. The Parliament (*Saeima*) has 100 members, elected for a four year term by proportional representation with a 5% threshold. Another important difference between the two countries is that whereas U.S. has a two-party system, Latvia has about seven significant political parties. Coalition politics is important in Latvia because parliamentarian majority chooses members of the Cabinet of Ministers.

Proportional system of representation and the turbulences of transition period produced substantial instability in the political system, especially in the 1990s. Since restoration of independence in 1990 and up to 2005 there were 12 changes in the ruling coalition. In spite of frequent changes of governments and the ruling coalition, however, there was one attribute of Latvian politics that stayed relatively constant throughout the 1990s – the presence of the 'Latvian Way' party. As illustrated in Table 1, the 'Latvian Way' has been part of *every* coalition government from July 1993 to November 2002 and its members held the Prime Minister's office for most of the period. In October 2002 election, however, the 'Latvian Way' won only 4.9 percent of the votes and fell short of the 5 percent threshold needed to get into the Parliament.

The 2002 election was one of the biggest turbulences in Latvia's politics, as shown in Table 2. Two parties ('Latvian Way' and 'Social Democratic Labor Party') with large representation in the previous legislature were not re-elected at all. Two parties ('New Era' Party and 'First Party') that won more than a third of all seats in the election had zero seats in the previous legislature.<sup>7</sup> Essentially, the election was largely a bitter contest between the 'People's Party', closely associated with business interests of a well-known businessman, and the 'New Era Party', which ran on an anti-corruption platform. Given the election result, the only stable coalition was that of the 'New Era Party', 'First Party', 'For Fatherland and Freedom', and 'Union of Green and Farmers', which together had 55 votes.<sup>8</sup> This was the coalition that was formed. However, this meant that the coalition led by the New Era party required support of *every* one of the smaller parties to form a working government and keep its main rival, the People's Party, in the opposition. The coalition headed by the New Era party stayed in power until March 2004.<sup>9</sup>

What made the 2002 election special, however, is that the failure of the 'Latvian Way' was *unanticipated* throughout most of the election period. Figure 1 shows monthly polling predictions for the 'Latvian Way', 'First Party', and 'New Era' in the 2002 election cycle. For most of the election period the polls predicted that 'Latvian Way' was comfortably above the 5% threshold, and looked set to reap all the benefits from participating in the coalition formation. Only in September, one month before the election date, the polls fell dangerously close to the threshold.<sup>10</sup> Another surprise in the election was the victory of the 'First Party' which, according to the polls, was not supposed to be elected at all.

Regulation of campaign contributions in Latvia was relatively lenient during the 2002 election cycle. The 1995 law on financing of political organizations explicitly

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<sup>7</sup> Union of Greens and Farmers appeared as a result of a merger between two parties, one of which was represented in the previous legislature.

<sup>8</sup> The 'For Human Rights in United Latvia' party was effectively excluded from the coalition calculus because it represented Latvia's sizable Russian-speaking minority. One of the results of bitter ethnic division between Latvians and a Russian-speaking minority is that a 'Russian' party never got close to being in the ruling coalition.

<sup>9</sup> In March 2004, the New Era lost prime minister's office (the highest executive post) and People's Party made its way back into the ruling coalition. In December 2004 the People's Party took the prime minister's office.

<sup>10</sup> In contrast, the polls for Social Democratic Party, which also was not re-elected, began oscillating around 5% already in June.

allowed businesses and private individuals to contribute to political parties and set contribution limit to 25,000 LVL to one party in one year. Amendments passed in June 2002 reduced the ceiling to a maximum of 10,000 LVL a year, to any number of parties. The total amount spent in the 2002 election cycle (January 1 to October 5) was 5.4 million Latvian lats. For comparison, across all U.S. elections in 2004, the grand total spent is estimated to be about \$4 billion (Stratmann, 2005, p. 135). Although in absolute terms this may seem a small amount as compared to the U.S., as a percentage of GDP it is nearly twice as high.

There is plenty of anecdotal evidence that businesses in Latvia use campaign contributions to buy political favors. In 2007 agents of anti-corruption agency (*KNAB*) unexpectedly raided corporate offices of a well-known Ventspils tycoon, Mr. Lembergs. They found what appeared to be a legal contract between two parties that identified themselves only by the letters “V” and “S”. Observers deduced that “V” stood for Ventspils, home city of Mr. Lembergs, whereas “S” stood for social-democratic party, ousted in the 2002 election. According to terms of the contract, “S” promised to withhold any support from ‘People’s Party’, closely associated with Mr Skele, a long-time rival of Mr. Lembergs. “S” also pledged to block participation of foreign companies in privatization of large state-owned enterprises and lobby for legislation favorable to industries in which Mr Lembergs had stakes. In return, “V” pledged hefty annual contribution as well as support in one of Latvia’s largest newspapers, widely believed to be controlled by Mr. Lembergs.

### 3. Methodology

This section discusses the specific hypotheses tested in this paper, the econometric methodology, and measurement of campaign contributions and firm performance.

Consider the following outcome equation:

$$y_{it} = \varphi D_{it} + \beta X_{it} + u_{it} \quad (1)$$

where  $y_{it}$  is the outcome of interest for firm  $i$  at time  $t$ .  $D_{it}$  is the indicator of whether a firm made a campaign contribution, which for simplicity is assumed to be binary. Thus,  $D_{it} = 1$  if a firm made a campaign contribution directly or through its board member or a significant shareholder in the previous election cycle, and zero

otherwise. A control group of firms that did not contribute is obtained by identifying a matched peer of similar size and in the same industry for each firm that contributed.  $X_{it}$  are other covariates used as controls such as size, measured by logarithm of total assets, and industry at NACE4 level. The  $u_{it}$  is an error term.

The outcome of interest is measured in logarithm of a firm's gross sales. This paper uses sales as a measure of performance because of its simplicity and reliability, as compared with other proxies. Measuring performance in a transition economy is tricky because of widespread tax evasion.<sup>11</sup> Thus, accounting profits are likely to be underestimated because of underreporting. Measures of productivity are also inaccurate because many companies (nearly a third in my sample) do not report number of employees. Moreover, underreporting of the number of employees is likely to be correlated with performance because firms with large sales and small number of employees may be afraid of attracting attention of the tax authorities.

If campaign contributions help secure favors from politicians, this should be reflected in firm-level performance. Thus, my hypothesis is that  $\varphi > 0$  if contribution was to a winning firm. However, a naive estimation of equation (1) will be fraught with difficulties because  $D_{it}$  is likely to be correlated with  $u_{it}$ . A firm may expect to exogenously benefit from the policy of a certain political party. For example, a firm in agriculture may benefit from agricultural subsidies and, thus, contribute to increase electoral chances of a party (e.g. Farmers' Union in Latvia) that promises such subsidies. In that case, better performance following election of Farmers' Union will simply indicate that this company benefited from the party's platform, not that it receives any special benefits due to its campaign contributions. This will generate an upward bias in the estimate of  $\varphi$ . Working in the opposite direction is the possibility that a firm may contribute because a rival firm has contributed (or is expected to) to a political party for the purpose of achieving preferential treatment, which will hurt other firms in its industry. Thus, a firm that expects a low draw of  $u_{it}$  is more likely to contribute to counter rent-seeking efforts of its rivals, generating downward bias in the estimate of  $\varphi$ .

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<sup>11</sup> See Schneider and Enste (2000) for quantitative estimates and a discussion of shadow economy in transition economies, including Latvia.

Clearly, endogeneity of campaign contributions needs to be controlled for to get a consistent estimate of  $\varphi$ .

The fact that data on campaign contributions are only available for the 2002 election period, and not earlier, implies that there are only two periods: before and after the elections. Thus, equation (1) can be transformed by taking first differences:

$$\Delta y_i = \varphi D_i + \beta \Delta X_i + v_i \quad (2)$$

where  $\Delta y_i$  is the first difference in the logarithm of sales between the period after election and the before-election period, when campaign contribution was made.  $D_i = 1$  if a firm made a campaign contribution and zero otherwise.  $\Delta X_i$  is the first difference of firm-level covariates. This difference-in-difference specification controls for permanent unobserved heterogeneity that might be correlated with  $D_{it}$  but does not solve endogeneity problems. Also, it is likely that campaign contribution in 2002 election cycle could be part of an ongoing relationship between politicians and a firm, but the data on contributions before 2002 are not available. This implies that some firms could be ‘treated’ also before the 2002 election.

To address the above issues I make use of the fact that the failure of the ‘Latvian Way’ and the election of the ‘First Party’ were *unanticipated* by firms that were seeking to buy political favors with campaign contributions to these two parties. Thus, the 2002 election produced *exogenous* changes in the strength of political connection for these firms. Consider a variant of equation (3) with party-specific contributions and industry fixed effects:

$$\Delta y_{ig} = \sum_g \varphi_g D_{ig} + \beta \Delta X_{ig} + \mu_k + v_{ig} \quad (3)$$

where  $g$  subscript denotes political party to which firm  $i$  contributed.  $\mu_k$  is industry fixed effect, which controls for industry specific trend. My hypothesis is that firms that donated to the ‘Latvian Way’ experienced deterioration in their performance after the 2002 election, whereas firms that donated to the ‘First Party’ experienced improvement in their performance, relative to other firms in the same industries. Specifically, the hypotheses are that  $\varphi_{LW} < 0$  for firms that contributed to the ‘Latvian Way’, and that  $\varphi_{LW} > 0$  for firms that contributed to the ‘First Party’. Given endogeneity concerns, I have no clear predictions for the effects of contributions to other political parties.

By including industry fixed effects  $\mu_k$  I mitigate the concern that changes in the performance of firms come as a result of implementation of exogenous ideology of the winning parties, and not as a result of individual campaign contributions. Implementation of election platform is likely to affect firms on an industry-wide basis, e.g. granting subsidies to agricultural firms. If a firm that gave campaign contribution benefits relative to firms that did not contribute but are in the same industry, this is likely to be a result of firm-specific political favors.

Finally, in a variation of equation (3), I replace an indicator variable  $D_{ig}$  with a continuous variable  $C_{ig}$ , which measures contribution amount to party  $g$  in thousands of Latvian lats (1LVL  $\approx$  2\$). If a firm contributed several times, or also through its board members and significant shareholders,  $C_{ig}$  is a sum of all these contributions in the 2002 election cycle. Equation (3) is estimated using OLS with heteroskedasticity-consistent robust standard errors and industry fixed effects at NACE 4 digit level of detail. Most specifications use panel data for contributing firms and their matched peers for 2002 and 2003, the first re-election year. This is because two more changes in the ruling coalition in 2004 led to further changes in the strength of political connection of firms that contributed in the 2002 election cycle. As a robustness check, I also estimate equation (3) using differences between averages of gross sales in 2000-2002 and in 2003-2005, respectively. The advantage of this approach is that it reduces measurement error concerns.

This paper also explores the effect of contributing in 2002 election cycle on outcome in 2003-2005 by using the following specification:

$$y_{it} = \theta_1 + \theta_3 d03_t + \theta_4 d04_t + \theta_5 d05_t + \sum_{M}^{j=1} \omega_{3g} d03_t C_{ig} + \sum_{M}^{j=1} \omega_{4g} d04_t C_{ig} + \sum_{M}^{j=1} \omega_{5g} d05_t C_{ig} + \beta X_{it} + \alpha_i + \varepsilon_{it} \quad (4)$$

where  $y_{it}$  is log of sales of firm  $i$  sales in year  $t$ ;  $x_{it}$  is a vector of firm-level control variables;  $S_{i,g}$  is donation sum of firm  $i$  to party  $g$  in the 2002 election ( $j = 1, \dots, M$ );  $\alpha_i$  is a firm fixed effect; and  $d03_t, d04_t, d05_t$  are year fixed effects for 2003, 2004, and 2005, respectively.  $\theta_1$  is the intercept for the base time period, i.e. year 2002. The variables of interest are the interaction terms between year fixed effects and contributions to political

parties in the 2002 election cycle. Equation (4) is estimated using OLS with year and firm fixed effects, and heteroskedasticity-consistent standard errors clustered at the firm level.

All models are estimated with dummy variables for the first and last years of a firm's operations to control for the possibility that the firm could have been operating for less than full year.

#### 4. Data and Summary Statistics

This section describes the sources of the data, the process of matching firms to politicians and donors, matching of connected firms to their matched peers, and provides some descriptive statistics.

##### a. Sources of the data

I construct a new dataset of firms that contributed to the 2002 election campaign by combining two sources of data. First, there are Business Registry data on all registered firms in Latvia, their owners and board members in 1991-2005. Second, there are firm and individual level data on campaign contributions from Latvian anti-corruption bureau in 2002-2005. Each of the data sources is briefly described below.

Firm-level data are provided by *Lursoft* Inc., a private firm which operates the online electronic database of the Business Registry, with detailed information on all firms registered in Latvia.<sup>12</sup> Data on firms' shareholders and board members are available for 1991-2005, whereas annual data on balance sheets and profit/loss accounts are available for 1996-2005.

The data on campaign contributions come from the online database of *KNAB*, Latvia's anti-corruption bureau.<sup>13</sup> The database covers all registered campaign contributions at the individual or firm level during the four year period in 2002-2005. For each contribution I know its sum, the date when it was made, and the political party that received it. Furthermore, I know the name, last name and birth date for individual donors and registration number for firms - donors. The total amount contributed in the 2002 election campaign was about 5.4 million LVL (1LVL $\approx$  2\$), with 1.7 million LVL

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<sup>12</sup> See [www.lursoft.lv](http://www.lursoft.lv)

<sup>13</sup> See <http://www.knab.lv/db/donations/>

contributed directly by firms and the rest by individuals. Most contributions come from individuals and are relatively small.

It should be noted that the data on campaign contributions were only published online on February 1<sup>st</sup>, 2003 – four months after the election. Thus, identities of individual donors were not subject of substantial public scrutiny during the 2002 election cycle.<sup>14</sup>

#### b. Matching firms to politicians

The definition of corporate campaign contribution used in this paper encompasses contributions made by a firm directly as well as contributions made by the firm's board members and significant shareholders (defined as controlling at least 10 percent of a company's shares). This provides a more accurate measurement of campaign contributions from business interests because businesses could attempt to conceal their donations by providing campaign finance through connected individuals.

I am able to match individual donors to firms as firm-level data contains information on the identities of shareholders and board members. For any registered firm the *Lursoft* database contains the names and personal codes of shareholders and board members. Using this information I match campaign contribution data to firm-level data in the 2002 election cycle, which covers January 1<sup>st</sup>, 2002 to October 5<sup>th</sup>, 2002. Matching is done using a carefully developed algorithm that identifies firms whose shareholders and board members gave contributions.<sup>15</sup> Banks, government-owned firms, non-profit organizations are excluded, as well as the firms that were not active (had zero gross sales) in 2002.<sup>16</sup> I also exclude small donors who contributed less than 500 LVL (1LVL $\approx$  2\$) in

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<sup>14</sup> KNAB assumed responsibility for processing the data on campaign contributions on June 27<sup>th</sup>, 2002. Before that, all political parties had to register campaign contributions with the State Revenue Service. Although, in principle, these were available upon request, obtaining these data in practice is hard. All our efforts to obtain data on campaign contributions prior to January 1<sup>st</sup> 2002 from the State Revenue Service were futile.

<sup>15</sup> To make sure that the algorithm worked correctly, we began by matching 53 randomly selected donors to firms by hand, using *Lursoft's* online database. These hand-collected data were then compared to the data produced by the algorithm to identify any differences and make corrections to the algorithm when necessary. When the data produced by the algorithm perfectly matched hand-collected data, we used the algorithm to do the matching for remaining donors and politicians.

<sup>16</sup> The main rationale for excluding banks was that it would probably be impossible to match to a non-connected bank. Not only are the Latvian banks relatively few but most likely all of them seek political influence in one way or the other.

any year.<sup>17</sup> Since a donating firm may own other firm(s), I also identify companies in which individual donors have shares through other companies.<sup>18</sup>

Matching is done very accurately because firm-level data contains information on shareholders' and board members first names, last names, and eleven-digit *personal codes*, which are functionally similar to social security numbers in U.S. The first six digits of a personal code represent a person's date, month, and year of birth. Data on campaign contributions by individuals contain an individual's first and last name, as well as first six digits of the personal code, which enables accurate matching of donors to firms.

There are 193 firms that contributed directly in the 2002 election cycle. As a result of matching individual donors to firms, I identify 747 firms in which 517 individual donors are significant shareholders or board members. As some firms contributed directly as well as through their board members or shareholders, I have a total of 889 firms in my sample. The firms in my sample contributed a total of 4.2 million LVL in 2000 prices, which makes the bulk (77.6%) of the total contributions in the 2002 election cycle.

### c. Matching to non-connected firms

Unfortunately, using the data on all firms in the estimation was not possible because of sensitive nature of the data.<sup>19</sup> Thus, this paper proceeds using the simplest possible matching techniques.<sup>20</sup> For every connected firm, a match is sought in the whole universe of registered firms, *except* firms that were already identified as politically connected.<sup>21</sup> A necessary eligibility condition is that a potential match must be active in the years that a connected firm was active and operate in the same industry. Matching is done in 2001 – the year preceding the campaign contribution. For each connected firm, a match is

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<sup>17</sup> This represents the bulk of all contributions – nearly 98% of the total sum contributed by individuals.

<sup>18</sup> However, firms owned by a politically connected firm in which a donor is only a board member are not considered to be politically connected.

<sup>19</sup> Lursoft Inc., operator of the Business Registry database, would not agree to provide firm-level data on all firms for the estimation purposes.

<sup>20</sup> Using more sophisticated techniques such as propensity-score matching was also not feasible because of technical limitations of the Lursoft database.

<sup>21</sup> This paper is part of a larger project aimed to investigate the nature of political connections in Latvia. The definition of politically connected firm in this project is any firms with a significant shareholder or board member who has or had been a politician in 1991-2005 period or made a campaign contribution in 2002-2005 period.

identified among all the firms meeting eligibility requirements (not connected, active in the period, same industry) using the nearest-neighbor matching in terms of assets. Another necessary condition is that the difference between assets of the connected firms and its matched peer should not exceed 40% of the assets of connected firm.<sup>22</sup> Matching is done without replacement. When identifying all potential matches in the same industry we begin with the primary 4-digit NACE classification, assigned by the Latvian Central Statistical Bureau. If no company satisfies these criteria, the process is repeated at 3-digit NACE, and then at 2-digit NACE.

I now report the results of matching connected firms to their peers. After removing firms with missing industry classification, 878 firms were submitted for matching and 844 firms were successfully matched. Most firms (759) were matched at the four digit NACE level, 43 firms - at the three digit level, 42 firms - at the two digit level, and no matches could be identified for 34 firms. The most popular activities of donating firms are “wholesale trade” (11%), “real estate” (10%), “other business activities” (10%), “retail trade” (10%), and “construction” (7%).

#### d. Descriptive Statistics

In this section I report descriptive statistics for the datasets on contributing firms and their matched peers.

Table 3, Panel A compares selected financial characteristics for firms connected to politicians and their matched peers in the year of matching. The table shows that, in terms of assets, firms connected to politicians have very similar size as compared to their matched peers. Interestingly, Panel A also indicates that the distribution of sales for connected firms is skewed to the right, as compared with their matched peers. Another interesting fact is that connected firms have lower profits and somewhat lower leverage. None of the differences are statistically significant, however. Panel B presents similar statistics for firms connected to donors in 2002 elections and their matched peers. Connected firms are somewhat larger in terms of both total assets and total sales, as compared with their matched peers, although this difference is not statistically

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<sup>22</sup> Size of the caliper is the same as used in a study by Faccio, Masulis, and McConnell (2006).

significant. Connected firms have lower return on assets, as compared with matched peers, and this difference is statistically significant at 10% level of significance.

Table 3 shows basic structure of the data on 844 corporate donors for which matched peers were successfully identified. This is an unbalanced panel with a maximum of ten years of data for a firm. 186 firms contributed directly, and the others have individual donors among their board members and significant shareholders. Donations are counted at the firm level, and not on the level of individual donors. The average donation per firm was 8.3 thousand LVL. 184 firms donated, on average, 6.8 thousands LVL each to the *Latvian Way* party. Fewer firms (98) contributed to the *First Party* but each firm's average donation was nearly twice as large – 12.2 thousand LVL. As an aside, I note that there is substantial loyalty among the donors because nearly 79% of all companies in my sample focused their donations on only one particular party. For example, the number of firms in my sample that donated exclusively to the *Latvian Way* and to the *First Party* is 124 and 65 firms, respectively.

Table 4 presents means and medians for firms connected to politicians and their matched peers, and tests for differences in means. Panel A presents the statistics for 2001, the year in which matching peers were identified. Donor firms are somewhat larger in terms of both total assets and total sales, as compared with their matched peers, although this difference is not statistically significant. Interestingly, contributing firms have substantially smaller return on assets, as compared with their matched peers, and this difference is statistically significant at 10% level of significance. Panel B presents the statistics for 2002 - the year in which the firms donated to political parties, whereas Panel C presents the same statistics for 2003 - the year after the election. The difference in total sales of donors firms and their matched peers has increased in 2003, as compared with 2002, but is not statistically significant. Donors firms had much lower return on assets, as compared with their matched peers, before as well after the election. This difference, however, became smaller in absolute terms in the year after the election. As it was already mentioned, interpreting differences in return on assets is difficult because of widespread tax evasion. One interpretation is that firms that did poorly were more likely to give campaign contributions. Another possible interpretation, however, is that firms that contributed found it easier to underreport profits.

## 5. Empirical Results

In this section I provide results of my empirical analysis. Table 5 presents OLS regressions to test my hypotheses. Panel A presents the results using dummy variables as measures of donations to different political parties. The dependent variable is difference of log of sales (or log of growth in sales) between the post-election period, and after-election period. I begin by pooling 2002 and 2003 data and taking first differences. My sample of first differences for 2002-2003 contains 1543 observations. For all the regressions I report heteroskedasticity-consistent standard errors. In addition, dummy variables for the first and last years of operation are included in each regression, but not reported.

Regression (1) in Panel A of Table 5 tests whether firms that donated in the 2002 election performed better after the elections, as compared with their matched peers. The coefficient is somewhat negative but not statistically significant. In regression (2) controls for change in assets and industry fixed effect (at 4 digit level) are added. Adding these controls does not change the main result. There is no evidence that donors generally performed better compared with the control group in 2002-2003.

Next, I test the main hypothesis that firms that donated to the ‘Latvian Way’ underperformed, whereas firms that donated to the ‘First Party’ outperformed their matched peers after the elections. In Regression (3) I include a set of dummy variables measuring whether a firm has donated to any of the major political parties. The results in this regression support my hypothesis by showing a negative and statistically significant coefficient of -0.24 for making a donation to the ‘Latvian Way’. The coefficient of 0.16 for making donation to the ‘First Party’ is positive but not statistically significant. I also find a positive and statistically significant coefficient for firms that donated to the ‘New Era’ party and a negative and statistically significant coefficient for firms that donated to the ‘For Fatherland and Freedom’ party. These results are not surprising. The ‘New Era’ was one of the winners in the election, whereas ‘For Fatherland and Freedom’ received 60% fewer seats as compared with the previous election result and, therefore, experienced a decrease in its political power. In regression (4) controls for industry and change in assets are added. Adding these controls somewhat reduces the magnitude of the

coefficients for donating to the ‘Latvian Way’ and the ‘New Era’ but these are still statistically significant. The results show that a firm that donated to the ‘Latvian Way’ experienced nearly 20% drop in its sales in 2003, as compared with matched peers. The coefficient for donating to ‘For Fatherland and Freedom’ drops in magnitude and becomes statistically insignificant. Taken together, the results in Regressions (3) and (4) provide partial support for my hypothesis. The coefficient for donating to the ‘Latvian Way’ is negative and statistically significant in both specifications. The coefficient for donating to the ‘First Party’ is positive but not statistically significant.

In regressions (5) and (6) I subject my main result to a more detailed analysis by focusing on *loyal* donors, i.e. firms that contributed exclusively to one party. In these specifications firms that contributed to more than one party are classified as having donated to “other parties”. In regression (5) I replicate the results in Regression (3), and in Regression (6) I replicate the results in Regression (4). The main result is that the estimated coefficient of donating to the ‘Latvian Way’ increases in magnitude and statistical significance. According to regression (6), a firm that contributed *only* to the ‘Latvian Way’ experienced a decrease in sales by nearly 30%, substantially more than firms that diversified their contributions. On the other hand, the coefficient for donating to the ‘New Era’ party dropped in magnitude and became statistically insignificant. Summing up, loyal donors that gave to the ‘Latvian Way’ suffered more than donors that contributed to other parties. However, there is no evidence that loyal donors to the ‘First Party’ gained in sales in the after-election year.

Next, in regressions (7) and (8) I return to conventional measurement of donations and further refine my analysis by analyzing longer ‘before’ and ‘after’ periods. I pool the data for 2000-2005 and examine difference between log of average sales in 2003-2005 and log of average sales in 2000-2002. The advantage of this approach is that it mitigates concerns that donors and matched peers may have had different trends before and after the elections, even after controlling for industries. This approach also mitigates measurement error concerns. The drawback is that taking longer time periods may result in more ‘noise’, as there were a number of changes in the ruling coalition and, thus, political strengths of political parties during these periods. In regression (7) I replicate the results in Regression (3), and in Regression (8) I replicate the results in Regression (4).

The main result survives this robustness check. Moreover, the coefficient on donation to the ‘Latvian Way’ increases in magnitude, implying that a donor to the ‘Latvian Way’ experienced a nearly 27% drop in average sales in 2003-2005 as compared with average sales in 2000-2002, relative to matched peers that experienced the same change in size in the same industry. However, the coefficient on donations to the ‘First Party’ is not statistically significant.

In Table 5, Panel B I replace dummy variables with donations sums, measured in thousands of LVL (1LVL $\approx$  2\$). First, in Regression (1) I examine whether total donation amount is correlated with log of sales growth in 2003. The estimated coefficient is not statistically significant. Adding controls for industry and changes in size in Regression (2) does not change this result.

Next, I break down total donation into donations to each of the major political parties in 2002 election. Estimation results for this new set of variables of interest are reported in Regression (3). The results in this regression strongly support the main hypothesis by showing negative coefficient for donating to the ‘Latvian Way’ and positive coefficient for donating to the ‘First Party’. Adding controls in Regression (4) for change in size and industry does not change this result. The estimated effects are statistically significant, similar in magnitude, and economically important. The estimated coefficient on donations to the ‘Latvian Way’ is -0.024, implying that a 1,000 LVL increase in donations results in a decrease in sales by 2.4%. On the other hand, the estimated coefficient on donations to the ‘First party’ is 0.022, implying that a 1,000 LVL increase in donations results in a increase in sales by 2.2%.

In most regressions with dummy variables in Panel A the coefficient of donating to the ‘First Party’ was insignificant, which may suggest that the effect of donations may be non-linear. In Regression (5) I investigate this possibility by adding quadratic terms for donations to the two parties of interest: the ‘Latvian Way’ and the ‘First Party’. In case of donating to the ‘Latvian Way’, the linear term is statistically significant, but quadratic term is not, implying that the effect of donations is linear. In case of the ‘First party’, both terms are insignificant. An F-test, however, rejects the hypothesis that both term are zero at 10% level of significance. The corresponding F-statistic for two-sided hypothesis test is 2.42. In both cases, therefore, I prefer a linear specification.

Next, I use longer ‘before’ and ‘after’ periods. My dependent variable is now the difference between log of average sales in 2003-2005 and log of average sales in 2000-2002. Regressions (6), (7), and (8) replicate the results in Regressions (3), (4), and (5), respectively, using this new dependent variable. The estimated coefficient on donations to the ‘Latvian Way’ is negative and statistically significant at 5% and 10% in Regressions (6) and (7), respectively. The magnitude of the effect is greater than in the previous regressions. According to Regression (7), a 1,000 LVL increase in donation to the ‘Latvian Way’ resulted in a decrease in average sales in the three year period in 2003-2005 by 4 percent. As regards donations to the ‘First Party’, the estimated coefficient of 0.034 in Regression (6) is positive and statistically significant, as expected. However, adding controls for change in assets and industry reduces the magnitude of the coefficient and makes it statistically insignificant. This implies that, over longer time period, increase in sales for donors to the ‘First Party’ was also accompanied by increase in assets. Finally, adding quadratic terms for donations to the ‘Latvian Way’ and the ‘First Party’ in Regression (8) suggests that the effect of donations is linear.

Further, I use panel data for 2002-2005 to estimate Equation (4). The dependent variable is log of sales. My pooled sample contains 5977 observations. In this specification I add firm fixed effects to control for time-invariant factors like managerial ability is to use fixed effects estimations. Although contributions to political parties do not vary over time, I can estimate whether contributions had different effects in different post-election years, as compared with the election year, using interactions between contributions in 2002 and years. These are the variables of interest. I include but do not report controls for size (log of assets), dummy variables for the first and last years of operation and firm and year fixed effects. I report heteroskedasticity-consistent standard errors corrected for clustering at the firm level. Estimation results are reported in Table 6.

The results provide additional support for my main hypothesis by showing negative coefficients for donations to the ‘Latvian Way’, and positive coefficients for donations to the ‘First Party’. For example, the estimated coefficient of interaction term between donation to the ‘Latvian Way’ and year 2003 is -0.029, implying that a 1,000 LVL increase in donation to this party resulted in 2.9% decrease in sales in 2003, as compared to 2002, and relative to firms in the same industry and of the same size that did not

donate. The estimated coefficients for interactions of years with donation to the ‘Latvian Way’ are statistically significant at 5% level for 2003 and 2004, and significant at 10% level for 2005. The results imply that the adverse effect on firms connected with this party persisted and increased in magnitude throughout all of the post-election period. In turn, the estimated coefficient of interaction term between donation to the ‘First Party’ and year 2003 is 0.028, implying that a 1,000 LVL increase in donation to this party resulted in 2.8% increase in sales in 2003. The estimated coefficients for interactions of years with donation to the ‘First Party’ are statistically significant at 10% level for 2003 and 2004, and significant at 5% level for 2005. Sizes of the coefficients are increasing with year, also suggesting that the positive effect for the firms that donated to this party persisted over time and increased in magnitude. Moreover, coefficient estimates on donations to the ‘Latvian Way’ and the ‘First Party’ are consistent with being equal but of the opposite sign. This suggests that after 2002 elections there was a redistribution of economic rents from the businesses connected with the ‘Latvian Way’ party to businesses connected with the ‘First Party’. The effects are very large in economic sense. An average donor to the ‘Latvian Way’ experienced almost 20% ( $6.8 * (-0.029)$ ) decrease in 2003 sales, as compared with a year before the election. In contrast, an average donor to the ‘First Party’ experienced 34% ( $12.2 * 0.028$ ) increase in 2003 sales, as compared with a year before. Although an average donor to the ‘First Party’ contributed nearly twice as much, as compared with an average donor to the ‘Latvian Way’, the total firm-level contributions for the two parties are nearly equal: 1,204 thousands LVL to the ‘First Party’, as compared with 1,251 thousands LVL to the ‘Latvian Way’.

The above results raise the question whether firms that contributed in 2002 election cycle also sought political connections before that. Unfortunately, the data on campaign contributions before 2002 are not available. Thus, I use donations in 2002 as a crude proxy for political connectedness before the 2002 to assess whether it was correlated with performance of firms in 1999-2002 period.<sup>23</sup> The estimation results using cross-sectional data for each year from 1999 to 2005 are reported in Table 7. The dependent variable is log of sales growth. The variable of interest is the dummy variable denoting whether the

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<sup>23</sup> I begin with 1999 because this is the first year after the negative economic shock caused 1998 Russian crisis. Besides, the number of observations drops sharply for earlier periods, as compared with my sample in 2002.

firm donated in 2002 election cycle. I also include an interaction term between whether a firm donated and whether donation went to ‘Latvian Way’, ‘People’s Party’, or ‘For Fatherland and Freedom’. These three parties were the main partners in the ruling coalition in 1999-2002. In all regressions I include controls for size (log of assets), and industry fixed effects at NACE 4 digit level. For all the regressions I report heteroskedasticity-consistent standard errors. In addition, dummy variables for the first and last years of operation are included in each regression, but not reported.

In Regression (1), the dependent variable is log sales growth in 1999. The estimated coefficient for donating of 0.14 is statistically significant, implying that in these years donors’ growth of sales was 14% higher compared to their matched peers. Interaction term with having donated to the three main parties in the ruling coalition is negative and insignificant. These results are not changed in Regression (2), where the dependent variable is log sales growth in 2000. In Regression (3), which uses data for 2001, both variables of interest are positive but not statistically significant. Joint F-test also fails to reject the hypothesis that both donation variables are zero. In regression (4) coefficients for both being a donor and its interaction with donating to three main parties in 2002 are positive but individually not statistically significant. However, joint test fails to reject the hypothesis that both values are zero at 5% level of significance. This implies that being a donor and, especially, donating to the three main coalition parties was correlated with growth in sales in 2002. A firm that donated to one of the main three coalition parties had sales growth in 2002 nearly 21% higher compared to its matched peers. Taken together, these results suggest that firms that donated in 2002 were also connected in the previous election period.

## 6. Conclusions

This paper addresses the question whether campaign contributions translate into better company performance. It focuses on the quasi-experiment provided by the 2002 elections in Latvia, when once influential ‘Latvian Way’ party was unexpectedly replaced by the ‘First Party’. Using a comprehensive measure of firm-level donations by companies and their board members and shareholders, this paper derives two main results. First, firms that donated to the ‘Latvian Way’ experienced substantial decrease in

their sales in the year after the elections. Second, firms that donated to the ‘First Party’ experienced substantial decrease in their sales in the year after the elections. The coefficient estimates are consistent with the effects of donating to these two parties being equal but of opposite signs. This suggests that departure of the ‘Latvian Way’ resulted in redistribution of economic rents to businesses connected to its political rival, the ‘First Party’.

Apart from building on a quasi-experiment provided by the departure of the ‘Latvian Way’, the unique contribution of this paper is that it focuses on a period when donors did not suspect that their contributions will become subject to public scrutiny, and that it also accounts for contributions of firms’ board members and shareholders. As a result, this paper provides new evidence on the value of political connections in transition economies. It also corroborates other evidence that firms derive rents from connections with politicians and that campaign contributions is one of the channels through which businesses pay for political favors. This paper also suggests that changes in the distribution of political power cause changes in the distribution of economic rents among connected firms.

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Figure 1: Monthly polls for the 2002 election for selected parties

This figure presents the monthly polls for the Latvian Parliamentary elections in 2002 for three parties. The horizontal axis represents the pre-election period in months and the vertical axis shows the predicted percentage of votes for *Latvian Way* (LW), *New Era Party* (NEP), and *First Party* (FP). The “Minimum Threshold” line represents the minimum 5% threshold necessary to get elected. The “Actual Results” vertical line represents actual results of the October 5, 2002 elections. These numbers are based on the poll data provided by the *Latvian Facts*, a public opinion research firm.

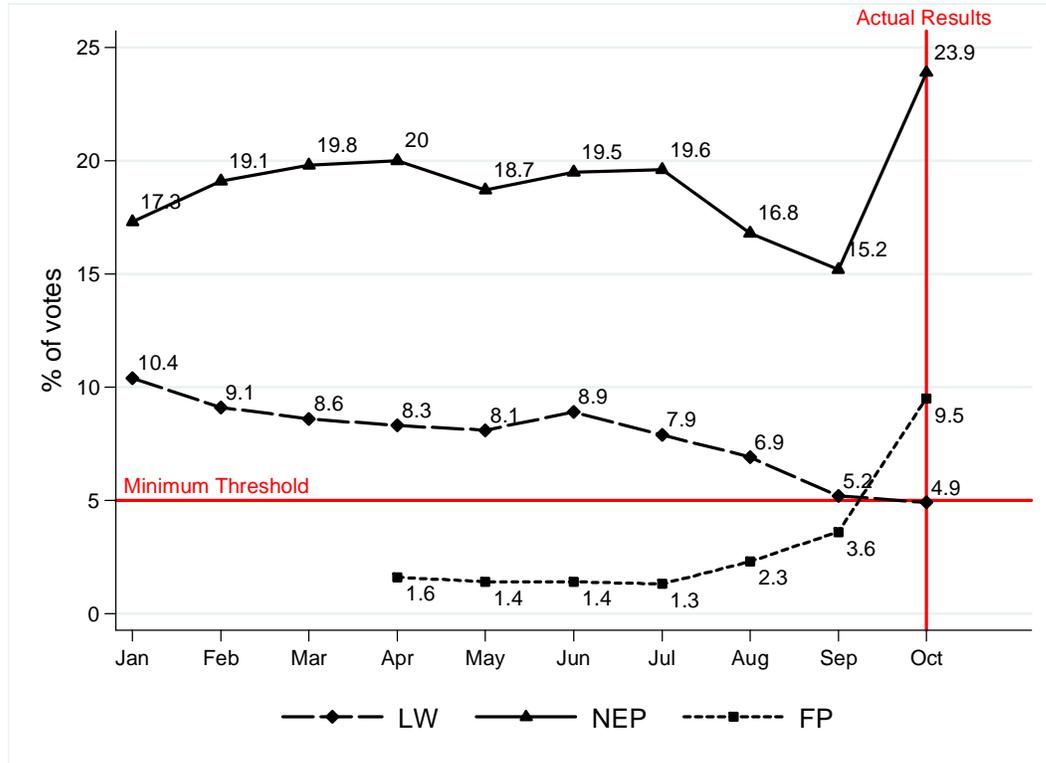


Table 1: Ruling coalition in 1996-2005

This table reports the political parties which made up the ruling coalition in the Latvian Parliament in 1996-2005 period. The party with an \* held Prime Minister's office.

21-Dec-95 to 13-Feb-97	13-Feb-97 to 7-Aug-97	7-Aug-97 to 26-Nov-98	26-Nov-98 to 16-Jul-99	16-Jul-99 to 2-May-00	5-May-00 to 7-Nov-02	7-Nov-02 to 9-Mar-04	9-Mar-04 to 2-Dec-04	2-Dec-04 to 7-Nov-06
Latvian Way*	Latvian Way*	For Fatherland and Freedom*	Latvian Way*	People's Party*	Latvian Way*	New Era*	Union of Greens and Farmers*	People's Party*
Union of Greens and Farmers	Union of Greens and Farmers	Latvian Way	For Fatherland and Freedom	For Fatherland and Freedom	For Fatherland and Freedom	Latvia's First Party	Latvia's First Party	Latvia's First Party
For Fatherland and Freedom	For Fatherland and Freedom	Latvian Christian Democratic Union	Latvian Christian Democratic Union	Latvian Way	People's Party	Union of Greens and Farmers	New Era	New Era
Latvian National Independence Movement	Latvian National Independence Movement	Latvian Farmers' Union	New Party	New Party	New Era	For Fatherland and Freedom	People's Party	Union of Greens and Farmers
Democratic Party 'Saimnieks'	Democratic Party 'Saimnieks'	Democratic Party 'Saimnieks'						
Latvia's Unity party								

Table 2: Results of the 2002 election

This table reports the outcome of the 2002 election for major political parties. Parties which failed to win more than 5% of the votes did not get to the Parliament. Change in the number of seats pertains to change in the number of seats in the Parliament after 2002 election, as compared with the previous election. All donations are in 2000 prices in Latvian lats (1LVL  $\approx$  2\$).

Parties and coalitions	% of the votes	Seats won	Change in the number of seats	Donations, LVL	% of total donations	Donations per vote, LVL
New Era Party (NEP)	23.9	26	26	381,825	8	1.61
For Human Rights in United Latvia (FHRUL)	19.0	25	9	342,122	7	1.81
People's Party (PP)	16.6	20	-4	1,146,618	24	6.94
Union of Greens and Farmers (UGF)	9.4	12	12	446,549	9	4.76
Latvia's First Party (LFP)	9.5	10	10	501,292	11	5.29
For Fatherland and Freedom (FFF)	5.4	7	-10	427,417	9	8.00
Latvian Way (LW)	4.9	0	-17	671,656	14	13.87
Latvian Social Democratic Labour Party (LSDLP)	4.0	0	-14	414,648	9	10.41
Total	100	100		4,735,137	100	4.75

Table 3: Data description

This table describes the data on political connections, both for the firms connected to (ex)politicians and the firms connected to donors. Political connection to a (ex)politician exists when he is a major shareholder (with >10% of shares) or a board member of an active company (with nonzero sales). Political connection to a donor exists when the firm donated as a corporate entity to the 2002 elections, or when an individual donor is a major shareholder (with >10% of shares) or a board member of this company. Conspiracy connection occurs if politician terminated connection in the year preceding his election, or in any year in his political career. Changes in the strength of political connection are on the level of the firm, not the politician. All donations are in thousands of 2000 Latvian lats (1LVL  $\approx$  2\$). Donations are on the level of the firm, and not the donor.

No. of years (maximum)	10				
No. of unique firms	844				
No. of firms that contributed directly	188				
No. of unique individual donors					
No. of firm-year observations	6,294				
	No of firms that	Donation amount, thous. LVL			
	donated	<i>Mean</i>	<i>SD</i>	<i>Min</i>	<i>Max</i>
Total donations	844	8.3	9.1	0.1	69.1
Donations to the “New Era Party”	177	5.6	6.1	0.1	23.9
Donations to the “People’s Party”	155	9.2	8.2	0.4	43.1
Donations to the “Latvian Way”	184	6.8	6.4	0.4	34.1
Donations to the “First Party”	98	12.2	7.7	1.3	37.3
Donations to the “For Freedom and Fatherland”	90	7.6	6.8	0.6	28.2
Donations to the “Union of Greens and Farmers”	46	5.1	4.6	0.4	14.3
Donations to the “FHRUL”	44	4.9	5.6	0.5	32.6
Donations to the “LSDLP”	86	6.6	5.1	0.4	23.9
Donations to other parties	166	3.8	4.7	0.1	32.6

Table 4: Summary Statistics for Contributing Firms and their Matched Peers

Thus table reports means and medians of selected financial characteristics for contributing firms and their matched peers. Panel A reports the statistics for 2001, the year in which matching was done. Panel B reports the statistics for 2002, the year when elections took place and contributions were made, and Panel C – for 2003, the after-election year. ROA are net profits after taxes divided by total assets times 100 from the company's financial report. Leverage is long-term debt divided by total assets times 100 from the company's financial report. Amounts are in 2000 Latvian lats (1LVL  $\approx$  2\$). P-values pertain to the t-test that the difference in means is zero.

Panel A: Year of matching (2001)						
	Contributing firms		Matched firms		Difference in means	T-test P-value
	Mean	Median	Mean	Median		
Total assets (thous. LVL)	832	145	767	139	65	0.58
Total sales (thous. LVL)	1093	172	941	166	152	0.33
ROA (%)	-8.13	0.85	-2.12	1.45	-6.01	0.06
Panel B: Election year (2002)						
Total assets (thous. LVL)	909	144	836	146	73	0.58
Total sales (thous. LVL)	1244	175	1064	169	180	0.41
ROA (%)	-19.36	1.25	-0.73	2.05	-18.63	0.00
Panel C: Post-election year (2003)						
Total assets (thous. LVL)	1010	165	916	164	94	0.52
Total sales (thous. LVL)	1433	187	1179	187	254	0.36
ROA (%)	-6.64	1.49	2.26	2.11	-8.9	0.01

Table 5: Impact of donations in the 2002 election

This table reports OLS regressions of the form:  $\Delta y_i = \sum_g \varphi_g D_{ig} + \beta \Delta X_i + \mu_k + v_i$  where  $\Delta y_i$  is log difference of firm  $i$  sales in 2002-2003;  $x_i$  is a vector of firm-level control variables;  $D_{ig}$  is dummy variable denoting whether firm  $i$  donated to party  $g$  in the 2002 election,  $\mu_k$  is the industry fixed effect. In Models (3) and (4)  $D_{ig} = 1$  if firm  $i$  donated to party  $g$ . In Models (5) and (6)  $D_{ig} = 1$  if firm  $i$  donated exclusively to party  $g$ . Models (1) to (6) are for the years 2003 and 2002, and Models (7) to (8) are for differences between logs of average sales in two periods: 2003-2005 and 2000-2002, respectively. Dummy variables for the first and last years of operations are included in all regressions, but these are not reported. Industry fixed effects are at the NACE 4 digit level. Heteroskedasticity-consistent standard errors are reported in parentheses. \*, \*\*, \*\*\* indicate significance at 10%, 5%, and 1% level, respectively.

Panel A: OLS regressions with dummy variables for donations								
Year	Difference of log sales							
	2002 – 2003				2000-2005			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Total donation	-0.012 (0.0438)	-0.028 (0.0454)						
Donation to Latvian Way			-0.24** (0.0927)	-0.22** (0.0882)	-0.33*** (0.110)	-0.35*** (0.117)	-0.28** (0.125)	-0.31** (0.131)
Donation to New Era Party			0.18** (0.0876)	0.17** (0.0860)	0.13 (0.0898)	0.13 (0.104)	0.13 (0.111)	0.093 (0.105)
Donation to Latvia's First Party			0.16 (0.122)	0.15 (0.113)	0.078 (0.128)	0.0067 (0.125)	0.25* (0.146)	0.12 (0.134)
Donation to People's Party			0.012 (0.0706)	-0.041 (0.0673)	0.033 (0.0829)	-0.086 (0.0877)	0.18* (0.0909)	-0.037 (0.0895)
Donation to For Fatherland and Freedom			-0.21** (0.108)	-0.14 (0.108)	-0.18 (0.122)	-0.093 (0.138)	-0.20 (0.144)	-0.091 (0.142)
Donation to Union of Greens and Farmers			0.097 (0.159)	0.12 (0.162)	0.21 (0.153)	0.29* (0.173)	-0.14 (0.242)	-0.18 (0.225)
Donation to LSDSP			-0.026 (0.104)	-0.085 (0.0990)	0.019 (0.109)	-0.013 (0.112)	-0.038 (0.157)	0.0047 (0.132)
Donation to FHRUL			0.0041 (0.266)	-0.068 (0.242)	-0.0056 (0.327)	-0.062 (0.301)	0.16 (0.280)	-0.075 (0.249)
Donation to other parties			0.028 (0.0907)	0.046 (0.0862)	0.038 (0.0798)	0.043 (0.0856)	0.056 (0.119)	0.070 (0.116)
Log difference of total assets		0.49*** (0.0630)		0.48*** (0.0583)		0.48*** (0.0619)		0.68*** (0.0676)
Industry fixed effect	NO	YES	NO	YES	NO	YES	NO	YES
Number of observations	1543	1541	1543	1541	1543	1541	1572	1572
R-squared (adjusted)	0.017	0.085	0.029	0.112	0.028	0.096	0.01	0.232

Table 5: Impact of donations in the 2002 election (continued)

This table reports OLS regressions of the form:  $\Delta y_i = \sum_g \varphi_g S_{ig} + \beta \Delta X_i + \mu_k + v_i$  where  $\Delta y_i$  is log difference of firm  $i$  sales in 2002-2003;  $x_i$  is a vector of firm-level control variables;  $S_{ig}$  is donation sum of firm  $i$  to party  $g$  in the 2002 election,  $\mu_k$  is the industry fixed effect. Models (1) to (6) are for the years 2003 and 2002, and Models (7) to (8) are for differences between logs of average sales in two periods: 2003-2005 and 2000-2002, respectively. All donations are on the firm level and in thousands of 2000 Latvian lats (1LVL  $\approx$  2\$). Dummy variables for the first and last years of operations are included in all regressions, but these are not reported. Industry fixed effects are at the NACE 4 digit level. Heteroskedasticity-consistent standard errors are reported in parentheses. \*, \*\*, \*\*\* indicate significance at 10%, 5%, and 1% level, respectively.

Panel B: OLS regressions with sums of donations								
	Difference of log sales							
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Total donation	0.0016 (0.00395)	-0.00014 (0.00392)						
Donation to Latvian Way			-0.025** (0.00989)	-0.024** (0.01000)	-0.054** (0.0244)	-0.041** (0.0185)	-0.040* (0.0206)	-0.064* (0.0347)
Donation to Latvian Way Squared					0.0016 (0.00103)			0.0013 (0.00175)
Donation to New Era Party			0.015 (0.00792)	0.011 (0.00960)	0.010 (0.00976)	0.012 (0.0117)	0.0059 (0.0104)	0.0051 (0.0106)
Donation to Latvia's First Party			0.028** (0.0123)	0.022** (0.0111)	-0.021 (0.0220)	0.034** (0.0156)	0.023 (0.0155)	-0.0092 (0.0302)
Donation to Latvia's First Party Squared					0.0018 (0.00114)			0.0014 (0.00166)
Donation to People's Party			0.0030 (0.00617)	0.00024 (0.00711)	-0.0022 (0.00736)	0.0091 (0.00773)	-0.00091 (0.00744)	-0.0028 (0.00749)
Donation to For Fatherland and Freedom			-0.019** (0.00929)	-0.013 (0.0100)	-0.013 (0.00998)	-0.015 (0.0106)	-0.0076 (0.0106)	-0.0083 (0.0106)
Donation to Union of Greens and Farmers			0.0054 (0.179)	0.016 (0.0190)	0.015 (0.0190)	-0.033 (0.0361)	-0.031 (0.0308)	-0.031 (0.0308)
Donation to LSDSP			-0.0023 (0.0118)	-0.0080 (0.0119)	-0.0094 (0.0119)	-0.0047 (0.0166)	-0.0036 (0.0148)	-0.0047 (0.0148)
Donation to FHRUL			-0.025 (0.0251)	-0.032 (0.0292)	-0.028 (0.0296)	-0.013 (0.0296)	-0.034 (0.0295)	-0.031 (0.0299)
Donation to other parties			0.0079 (0.0133)	0.012 (0.0156)	0.010 (0.0156)	0.014 (0.0197)	0.024 (0.0197)	0.022 (0.0197)
Log difference of total assets		0.49*** (0.0630)		0.48*** (0.0622)	0.48*** (0.0619)		0.68*** (0.0668)	0.68*** (0.0667)
Industry fixed effect	NO	YES	NO	YES	NO	YES	NO	YES
Number of observations	1543	1541	1543	1541	1543	1572	1572	1572
R-squared (adjusted)	0.017	0.085	0.031	0.094	0.101	0.015	0.238	0.240

Table 6: Donations in 2002 election and firms performance: interactions between donations and years in fixed effects regressions

This table reports OLS regressions of the form:  $y_{it} = \theta_1 + \theta_3 d03_t + \theta_4 d04_t + \theta_5 d05_t + \sum_{M=1}^{j=1} \omega_{3g} d03_t C_{ig} + \sum_{M=1}^{j=1} \omega_{4g} d04_t C_{ig} + \sum_{M=1}^{j=1} \omega_{5g} d05_t C_{ig} + \beta X_{it} + \alpha_i + \varepsilon_{it}$ , where  $y_{it}$  is log of sales of firm  $i$  sales in year  $t$ ;  $x_{it}$  is a vector of firm-level control variables;  $C_{i,g}$  is donation sum of firm  $i$  to party  $g$  in the 2002 election ( $j = 1, \dots, M$ );  $\alpha_i$  is a firm fixed effect; and  $d03_t, d04_t, d05_t$  are year fixed effects for 2003, 2004, and 2005, respectively. Each reported coefficient estimate is the interaction between donation to a party and the year. All donations are on the firm level and in thousands of 2000 Latvian lats (1LVL  $\approx$  2\$). Dummy variables for the first and last years of operations are included in all regressions, but these are not reported. Control variables are log of assets and leverage, but these are not reported here. Heteroskedasticity-consistent standard errors are reported in parentheses. \*, \*\*, \*\*\* indicate significance at 10%, 5%, and 1% level, respectively.

Panel A: Interactions with absolute amounts of donations			
	x2003	x2004	x2005
Donation to Latvian Way	-0.029** (0.0137)	-0.033* (0.0194)	-0.042* (0.0247)
Donation to New Era Party	0.009 (0.0095)	0.017* (0.0095)	0.017* (0.0095)
Donation to First Party	0.028* (0.0148)	0.029* (0.0165)	0.041** (0.0186)
Donation to People's Party	0.0032 (0.00734)	-0.0035 (0.00857)	-0.019 (0.0173)
Donation to For Fatherland and Freedom	-0.011 (0.0116)	-0.015 (0.0108)	-0.0071 (0.0129)
Donation to Union of Greens and Farmers	0.0073 (0.0210)	0.0071 (0.0225)	-0.015 (0.0350)
Donation to LSDSP	-0.0093 (0.0134)	-0.0041 (0.0153)	-0.012 (0.0185)
Donation to FHRUL	-0.029 (0.0272)	-0.046 (0.0322)	-0.048 (0.0356)
Donation to other parties	0.011 (0.0153)	0.025 (0.0180)	0.030 (0.0224)
Controls		YES	
Year fixed effects		YES	
Firm fixed effects		YES	
Number of observations		5977	
R-squared (adjusted)		0.921	

Table 7: Donations in 2002 election and firm performance: 1997-2005

This table reports OLS regressions with log of growth in sales as dependent variable. Donor in 2002 election is a dummy variables that takes the value of one if the company is a donor in the 2002 election Donor to ‘Latvian Way’, ‘People’s Party’, or ‘For Fatherland and Freedom’ is a dummy variable that takes a value of one if the company contributed to any one of those parties in the 2002 election. Dummy variables for the first and last years of operations are included in all regressions, but these are not reported. Industry fixed effects are at the NACE 4 digit level. Heteroskedasticity-consistent standard errors are reported in parentheses. P-values are presented in parentheses under F-statistics. \*, \*\*, \*\*\* indicate significance at 10%, 5%, and 1% level, respectively.

	Difference of log sales			
	(1)	(2)	(3)	(4)
Year	1999	2000	2001	2002
Donation in 2002 election	0.14** (0.0618)	0.14** (0.0579)	0.044 (0.0479)	0.079 (0.0609)
Donation to ‘Latvian Way’, ‘People’s Party’, or ‘For Fatherland and Freedom’	-0.13 (0.0854)	-0.045 (0.0897)	0.11 (0.0886)	0.13 (0.0812)
Log difference of total assets	0.60*** (0.0594)	0.47*** (0.0700)	0.40*** (0.0715)	0.47*** (0.0784)
Industry fixed effect	YES	YES	YES	YES
F-statistics and p-values of Joint Hypotheses				
All donation variables =0	2.52 (0.081)	3.05 (0.047)	1.95 (0.143)	4.51 (0.011)
Number of observations	941	1107	1285	1441
R-squared (adjusted)	0.226	0.168	0.139	0.067