

Even in Non-Corrupt Countries, Political Power Pays Off

Illegal rent-seeking may be rarer in Western developed nations, but that doesn't mean they shouldn't be concerned with transparency.

For three years in a row, Denmark has been named **the world's least corrupt country** by watchdog NGO Transparency International. Its worldwide reputation as a beacon of integrity largely stems from a uniquely effective combination of Scandinavian social-welfare programmes and business-friendly bureaucracy. If any place on the planet is free from preferential dealings between public servants and private enterprise, one would expect it to be Denmark.

But this is apparently not the case. My research into the finances of office-holders in the Danish municipal government (a collaboration with Mario Daniele Amore of Bocconi University and Kasper Meisner Nielsen of HKUST) shows that even in environments where outright bribery and kickbacks are rare to non-existent, power still pays dividends for local-level politicians, their families, and firms linked to them.

Return to power

Our results contradict **past studies** that found that the monetary gains from being elected to political office were insignificant. Unlike those prior studies, our research was able to tie individual politician's income to their level of influence, instead of treating all office-holders as essentially the same.

In doing so, we took advantage of Denmark's 2005 administrative reform, in which 239 municipalities were summarily merged into 69 larger municipalities, leaving 32 unchanged. Politicians re-elected in 2005 to the leadership of a merged municipality would have experienced a considerable increase in power—measured in terms of budget and size of their constituency - virtually overnight. Meanwhile, politicians re-elected to an unmerged municipality stayed at the same power level as before the reform, making them an ideal control group.

A significant increase

We completed the picture by plugging in comprehensive data provided by the Danish tax authority for the politicians and their families from the period 1997-2009. Our analysis (detailed in the working paper "**Return to Political Power in a Low-Corruption Environment**") found that the average re-elected politician in a merged municipality enjoyed an increase of around 3.8 percent in total personal income, compared to his or her peers from non-merged municipalities. Keep in mind that this figure excludes pay rises and other easily explicable proceeds from office-holding.

The average increase may be economically small, but it is statistically significant. It is especially so

considering the modest clout of many of these politicians, even by the standards of intra-Danish politics. If political power is seen to pay off for local party members in the world's least corrupt country (population: 5.6 million), how much larger would the potential gains be elsewhere in the world?

Moreover, higher-status pols received larger income bumps. We found an 8.5 percent increase for party leaders, 12.7 percent for coalition party leaders, and finally, 17.2 percent for mayors.

Longer-term gains

The larger the politician's jump in power via the merger, the greater the potential long-term financial benefit. We estimate that doubling the municipality's population size would, given enough time, yield by itself an average income increase of 2.7 percent for re-elected politicians. To give you an idea, merged municipalities in Denmark saw an average population increase of 260 percent. Doubling the budget size would eventually generate on its own, on average, 2.6 percent higher income for politicians; budgets ballooned by an average of 315 percent with the merger.

Board appointments

Our data did not include exact information on where the extra money came from, but one contributing factor appears to be corporate board appointments. We saw that merged-municipality politicians held appreciably more corporate directorships than the control group, a discrepancy that couldn't be explained by individual characteristics such as age. For politicians with above-median votes in the municipality and for party leaders, the directorships gap was especially wide.

Families and firms

Maybe the most remarkable pattern apparent here is that the income boost from power isn't limited to the politician alone; his or her close family members—adult children in particular—also get a taste. In fact, the power-income connection was twice as strong on average for the offspring than for the politician. The effect was strongest for children who resided in the same municipality as their parents.

Presumably, there are certain advantages to living and working within your powerful parent's sphere of influence - not only for yourself but also for your company. In the paper "**The value of local political connections in a low-corruption environment**" (published in *Journal of Financial Economics*), we analysed how the 2005 reforms impacted revenues at politically connected companies, i.e. those with either a politician or a close family member of one

as CEO and/or director. We found that firms connected to the newly enlarged municipalities reaped 3.1 to 3.4 percent greater profitability, a near-doubling of their average pre-reform operating performance.

Tellingly, the profitability increase affected only those firms that were low-performing prior to the reform. This is consistent with the idea that the least productive firms benefited the most from an increase in political power. Hence, political connections may serve to transfer rent from the most productive to the least productive firms.

Corruption?

To be clear, our findings are not meant to challenge Denmark's squeaky-clean reputation. Nothing we have seen suggests illegality of the sort that is rampant in high-corruption environments. It is worth reiterating that unlike many of their counterparts in corrupt countries, the subjects of our research have not amassed anything like great wealth. There is every reason to assume that legitimate business opportunities (such as corporate board appointments) and subtle deference to power are at play in Denmark, rather than systemic abuses of authority.

However, there are two commonly noted aspects of corruption - an attempt to circumvent existing rules, and a tendency to favour certain firms for no good reason - that do seem to be reflected in our evidence. We are led to conclude that even in the world's least corrupt country, a certain amount of legal "corruption" exists.

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