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Politics and Finance

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Abstract

Rising government intervention, corporate political spending, and geopolitical rifts underscore the importance of the link between politics and finance. This review describes how politics affects firms, banks, households, and markets. Companies form political ties through board connections, lobbying, revolving-door hires, and contributions. In return, they gain access to procurement contracts, cheaper debt, bailouts, policy information, and reduced enforcement. Political ties are generally associated with increased shareholder value but can also be costly during periods of political disruption. Political factors spill over to banking, where banks favor connected firms and secure regulatory forbearance; to households, whose partisan beliefs shape investments; to asset markets, which price political risk; and to global capital markets, where investment and banking flows respond to geopolitical risks. We conclude with open questions, including which types of money matter most in politics, how politics influences relational contracts, and the need to integrate political economy factors into finance theory.

Keywords: Political connections, campaign contributions, lobbying, corporate finance, political ideology, money-in-politics

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ABSTRACT

Rising government intervention, corporate political spending, and geopolitical rifts underscore the importance of the link between politics and finance. This review describes how politics affects firms, banks, households, and markets. Companies form political ties through board connections, lobbying, revolving-door hires, and contributions. In return, they gain access to procurement contracts, cheaper debt, bailouts, policy information, and reduced enforcement. Political ties are generally associated with increased shareholder value but can also be costly during periods of political disruption. Political factors spill over to banking, where banks favor connected firms and secure regulatory forbearance; to households, whose partisan beliefs shape investments; to asset markets, which price political risk; and to global capital markets, where investment and banking flows respond to geopolitical risks. We conclude with open questions, including which types of money matter most in politics, how politics influences relational contracts, and the need to integrate political economy factors into finance theory.

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1 INTRODUCTION

Over the last quarter century, governments have intervened in markets on an unprecedented scale, responding to the 2008 financial crisis, subsequent sovereign debt crises, and the Covid-19 pandemic, among other shocks. More recently, a worldwide resurgence of populism and backlash against globalization has reshaped the world economic order, culminating in the large-scale imposition of tariffs by the US government and other countries. Over this same period, the flow of money into US politics has surged: federal election spending rose from $5.6 billion in 2000 to $14.8 billion in 2024, while federal lobbying outlays increased from $2.7 billion to $4.4 billion.[1] Motivated by these striking trends, research at the intersection of politics and finance has expanded rapidly. In this paper, we review this growing body of work and offer our perspective on the key mechanisms linking political forces and financial outcomes, as well as the most promising directions for future research.

In a frictionless world, the link between politics and finance is straightforward: voters elect politicians to enact policies reflecting their preferences, and firms maximize shareholder value given these policies. For more than half a century, this narrative, popularized by Friedman & Friedman (1962), has served as the dominant normative theory of firm behavior. Yet just as product and financial markets feature frictions, so too do political markets. Incomplete contracting and information asymmetries among candidates, voters, and firms impede the translation of preferences into policy. Moreover, because politicians set the rules under which they are elected, a wedge may arise between the interests of the median constituent and those of the pivotal voting bloc. In the presence of such frictions, government intervention can amplify rather than mitigate failures in product and asset markets (Shleifer & Vishny, 1994), underscoring the importance of studying firms' and households' political actions and how such actions shape economic and financial outcomes.

We begin by surveying studies that treat the firm as the decision maker. The first branch of this literature asks two main questions: how do firms form political connections, and do such connections create shareholder value? The evidence indicates that firms cultivate ties through campaign

[1] These figures come from OpenSecrets, a non-profit, non-partisan advocacy group for transparency in US campaign finance.

contributions and lobbying; by appointing directors with political experience; via geographic or educational links; and by hiring through the revolving door, and that such ties generally create substantial value for shareholders.

A second line of work examines mechanisms through which firms benefit from their political connections. Politically-connected firms win procurement contracts more frequently, obtain more plentiful financing on better terms, receive preferential regulatory treatment, and gain access to operationally-relevant political intelligence; moreover, in some settings, firm-politician ties are associated with shifts in legislators' voting behavior. A final branch asks whether political connections impose costs on firms or other stakeholders. Here, studies find that political connections can destroy value during periods of political upheaval or when politicians face intense electoral competition.

A related literature examines the relationship between politicians and providers of capital, especially banks. Politically-connected banks and state-owned banks are more likely to lend money to politically-connected firms, even when such loans exhibit higher default risk. Politically-connected banks can also distort financial regulation in their favor. Given banks' position at the center of economy-wide capital allocation, politically-driven lending and regulatory distortions can result in credit misallocation and reduced economic growth.

Political frictions also manifest in asset markets. At the macro level, stock returns are affected by political cycles; in the United States, average market performance is higher under Democratic administrations. At the firm level, businesses that are more exposed to policy shocks or operating under greater policy uncertainty earn higher stock returns than other firms. At the investor level, information flows between policymakers and connected investors lead to higher investor-level returns; however, evidence is mixed on whether politicians themselves profit from private knowledge of policy or government spending outcomes.

Research on the role of politics in household finance documents large partisan gaps in households' economic outlooks. Individuals who identify with the party of the US president or who voted for Brexit in the UK are more optimistic about the stock market and macro-economy, with the partisan gap growing over time. However, partisan differences in expectations do not translate into systematic differences in consumer behavior. Nonetheless, partisan beliefs shape a wide range

of household financial and economic decisions, influencing stock-market participation, portfolio allocation, investor disagreement, entrepreneurship, and residential sorting. Lastly, research shows that household balance sheets influence voting behavior.

The literature on international capital flows finds that political relations between countries shape global capital flows. Bilateral political alignment, measured using indicators like UN voting similarity, increases foreign direct investment, portfolio flows, and cross-border M&A, while geopolitical tensions, such as the war in Ukraine, dampen them. Political distance also affects sovereign bond spreads, syndicated loan pricing, and cross-border bank lending. Finally, research on the political economy of financial development shows that reforms such as privatization and FDI liberalization are endogenous to political competition and the rent-seeking motives of incumbents, shaping both the timing and outcomes of financial reforms.

Figure 1 provides a timeline of the papers discussed in this review, organized into five major topic categories mirroring the topic categories described above. As can be seen from the figure, the literature on politics and finance has grown rapidly in recent years.

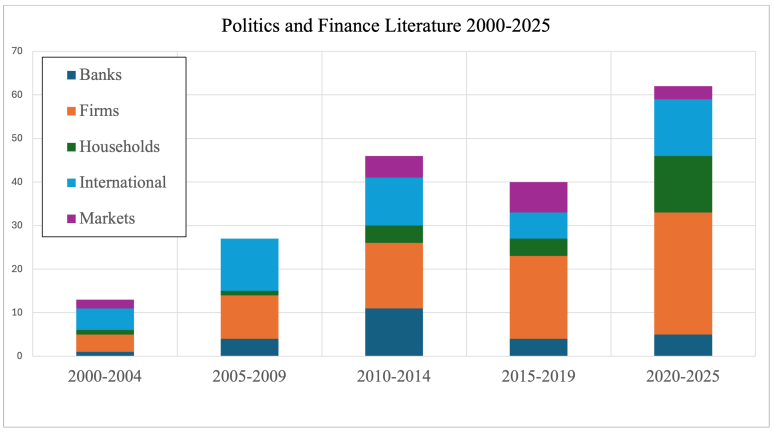

Figure 1. Growth in politics and finance literature 2000-2025

We organize our review as follows. First, Section 2.1 presents an overview of the many ways researchers define and measure political connections and assess their impact on firm value. Section 2.2 then discusses the variety of mechanisms through which firms benefit from political connections, and Section 2.3 examines the costs of political ties. We next turn to financial intermediation:

Section 3.1 analyzes how political connections shape bank lending, and Section 3.2 considers their role in bank regulation. Section 4.1 reviews evidence on political risk premia, while Section 4.2 discusses political cycles in asset markets. We next discuss politically informed trading in Section 4.3, household decision making in Section 5, and international capital flows in Sections 6.1 and 6.2. Finally, Section 6.3 reviews the political economy of financial reforms.

As with any survey, we have had to limit the scope of our literature review. We do not cover the extensive literature on the economic consequences of corruption or on political risk unrelated to specific political ties (e.g., Fisman & Miguel, 2007; Giambona, Graham & Harvey, 2017; Zeume, 2017), nor the growing body of work on political polarization (e.g., Kempf & Tsoutsoura, 2024). We also do not discuss the broad literature on country-specific institutions and firms (e.g., La Porta, Lopez-de Silanes, Shleifer & Vishny, 2000; Rajan & Zingales, 2003; Acemoglu, Johnson & Robinson, 2005) or studies on China's 2013 anti-corruption campaign and its political economy implications (e.g., Chen & Kung, 2019). Inevitably, space limitations mean we omit many excellent papers. We focus primarily on published work, citing selected working papers where useful for highlighting open questions and future directions.

2 FIRMS

We begin by surveying the literature studying the interactions between politicians and firms.

2.1 The Value of Firms' Political Connections

Are corporate political connections valuable? Although it may seem self-evident that shareholders should benefit from corporate political connections to incumbent governments, political ties between firms and governments are substantially more prevalent in countries perceived as corrupt or with fewer restrictions on political conflicts of interest (Faccio, 2006). Early work on this question studied the stock market reactions of firms exposed to important political events. For example, Roberts (1990) finds that firms that operated in the home state of or had contributed to Henry "Scoop" Jackson, Ranking Member of the US Senate Armed Services Committee, had large, negative cumulative abnormal returns (CARs) after his unexpected death. In a similar vein, Fisman

(2001) finds that Indonesian firms with ties to Indonesian dictator Suharto experienced negative CARs around rumors of his health deteriorating. Jayachandran (2006) finds that large donors to Republican candidates lost value when Jim Jeffords unexpectedly left the Republican party, causing control of the US Senate to pass from Republicans to Democrats.

Follow-up work moved away from single-event studies to understand the value implications of firms' political connections measured through campaign contributions in broader contexts. For example, Cooper, Gulen & Ovtchinnikov (2010) find that firms' campaign contributions are associated with higher stock returns in the following year, while Agarwal, Meshke & Wang (2012) find evidence that the amount of money firms spend on "soft money" political spending correlates with characteristics consistent with agency problems and that such spending is associated with lower future returns. Akey (2015) finds that the successful formation or continuation of political connections creates value by studying stock market reactions of firms connected to politicians that "just" win or lose close congressional elections.

A series of more recent papers has studied the firm value implications of the landmark Supreme Court ruling *Citizens United v FEC*.[2] The varied results of these studies highlight that understanding how political spending affects corporate valuation requires nuance and also illustrates that differences in the definition of political connections can be important. On the one hand, Coates IV (2012) finds that firms that engaged in lobbying or made campaign contributions had lower valuations than firms that had not after *Citizens United* was decided (as measured as Tobin's Q), which the author interprets as supporting an agency-based interpretation of political activity. On the other hand, Stratmann & Verret (2015) find that politically active firms earned positive CARs around the decision date, while Werner (2011) measures statistically insigificant CARs for various groups of firms around key dates in the *Citizens United* ruling. Albuquerque, Lei, Rocholl & Zhang (2020) find that firms that had political connections experienced lower CARs, but conclude that this is not due to agency concerns, but rather to a crowding out of the value of political activity that was displaced by the new forms of political spending allowed by the court ruling. More generally,

[2]The court case ruling increased the ease with with firms (and other constituents) could spend money in politics and decreased transparency for certain types of political spending. See Akey, Babina, Buchak & Tenekedjieva (2023) among others for details on the background of *Citizens United*.

the legalization of "dark money" has made it more difficult to systematically identify the political activity of firms (see, for example Spencer & Wood, 2014; Denes & Scanlon, 2025).

Other studies expanded the definition of political connections. For example, Agrawal & Knoeber (2001) examine the prevalence of directors with political expertise and Goldman, Rocholl & So (2009) show that the appointment of politically connected directors results in positive announcement returns. Faccio & Parsley (2009) find that firms headquartered in a politician's hometown experience negative returns around their sudden death. Other work has studied the value of social or business ties to politicians (e.g., Acemoglu, Johnson, Kermani, Kwak & Mitton, 2016; Child, Massoud, Schabus & Zhou, 2020) and finds it positive. Other work characterizes the "revolving door" of workers from industry to government and vice versa (e.g., Luechinger & Moser, 2014; Shive & Forster, 2017; Emery & Faccio, 2025). Bertrand, Bombardini, Fisman & Trebbi (2020) and Bertrand, Bombardini, Fisman, Hackinen & Trebbi (2021) find that firms use charitable contributions to non-profit foundations to build political capital and that these charities comment on proposed rules that impact the contributing firms.

Another line of research has studied the value of corporate lobbying. For example, Hill, Kelly, Lockhart & Van Ness (2013), Chen, Parsley & Yang (2015), and Ridge, Ingram & Hill (2017), provide evidence that lobbying activity is positively associated with firm value, while Borisov, Goldman & Gupta (2016) use a bribery scandal that negatively affected some firms to provide causal evidence that lobbying is value-enhancing for firms.[3] In a similar vein, Brown & Huang (2020) find that firms experience positive CARs when their executives meet with an incumbent president.

Finally, other scholars have examined the political activity of executives and non-executive employees. For example, Fremeth, Richter & Schaufele (2013) find that executives increase their personal political contributions after becoming CEO, while Richter & Werner (2017) find that CEO personal contributions can substitute for contributions made by PACs when candidates make pledges to stop accepting campaign contributions from PACs. Additionally, Gordon, Hafer & Landa (2007) and Fedaseyeu & Lvovskiy (2025) find that executives contribute more when their

[3] Kang (2016) uses structural estimation for lobbying activity in the energy sector in the 110th Congress and finds such activity to have a positive value.

financial incentives are better aligned with their shareholders. Teso (2025) finds that the personal contributions of executives target politicians who oversee policy areas of import to firms. Babenko, Fedaseyeu & Zhang (2020) and Stuckatz (2022) find that rank-and-file employees' individual campaign contributions align with those of their executives in a way that cannot be fully explained by common preferences.

In summary, the literature has concluded that firms establish and maintain political connections through a variety of methods and that these connections are generally valuable.

2.2 Mechanisms through which Firms Benefit from Political Connections

We next survey the literature on the many ways firms may benefit from political connections.

2.2.1 Government contracts

Numerous studies have shown that political connections enable firms to improve government contracting outcomes. For example, Cohen, Coval & Malloy (2011) show that senior US Senators are better able to steer federal spending to their home states. Goldman, Rocholl & So (2013) find that politically connected boards enable firms to receive more procurement contracts, while Akey (2015) finds that the sales of politically connected firms increase after candidates to whom they are connected win close elections. Tahoun (2014) finds that firms in which politicians own equity receive more government contracts. Moreover, the terms and profitability of procurement contracts are more favorable for politically connected firms. Ferris, Houston & Javakhadze (2019) show that politically connected firms have more favorable contract terms while Brogaard, Denes & Duchin (2021) find that politically connected firms are better able to renegotiate contract terms to extract value *ex post*. Politically connected firms also benefit from preferential access to government contracts in many countries outside the US (e.g., Amore & Bennedsen, 2013; Schoenherr, 2019).

2.2.2 Access to finance

Several authors provide evidence that political connections facilitate firms' access to finance. Dinç (2005) find that government-owned banks extend more credit during elections than their privately

owned peers, while Faccio, Masulis & McConnell (2006) find that politically connected firms are more likely to be bailed out. Subsequent work provides more detail on this channel by focusing on political connections within specific countries. For example, Charumilind, Kali & Wiwattanakantang (2006) find that politically connected firms in Thailand receive preferential lending terms compared to unconnected firms, while Khwaja & Mian (2008) find that politically connected firms in Pakistan weather funding shocks better than unconnected firms. Claessens, Feijen & Laeven (2008) find that Brazilian firms that made campaign contributions to successful candidates had higher leverage than firms that did not make such contributions. The relationship between political connections and access to credit persists in developed economies. For example, Houston, Jiang, Lin & Ma (2014) and Zhou (2023) find that politically connected firms in the United States pay lower spreads on bank loans but not on loans made in public markets. Finally, Adelino & Dinç (2014) and Duchin & Hackney (2021) provide evidence that political connections affect the allocation of government support to non-financial firms in times of economic stress.

2.2.3 Voting

A natural question is whether political connections influence voting behavior. Perhaps surprisingly, relatively few studies have shown a causal effect of connections on voting outcomes (Ansolabehere, De Figueiredo & Snyder Jr, 2003). However, identification is a key challenge. First, connections form endogenously, and it is difficult to empirically separate the matching between firms and legislators with similar political or policy preferences from the presence of a causal effect of political connections on voting outcomes. Second, voting is a discrete outcome, since a politician either votes for, against, or abstains on a particular bill. Politicians have substantial discretion to modify the substance of a bill before it comes up for a vote (and, in many cases, to impede it coming up for a vote at all). Third, and perhaps most subtly, it is difficult to observe comparable variation over time *for the same legislator* on votes on comparable laws.

Recent work provides some evidence that political connections affect legislative outcomes, albeit in situations that are particularly consequential for firms. For example, Stratmann (2002) shows that campaign contributions from the financial industry increased the probability that a member of

Congress changed their vote for the repeal of the Glass-Steagall Act. Tahoun & van Lent (2018) find that personal stock holdings of politicians affected their votes for legislation to bail out financial institutions during the Financial Crisis. Grier, Grier & Mkrtchian (2023) find that campaign contributions from the sugar industry increased the probability that the same legislator voted to preserve industry subsidies across different votes to remove them. Gao & Huang (2025) and Fich & Xu (2025) find evidence that political contributions from firms facing environmental burdens are associated with politicians voting more frequently against pro-environmental initiatives.

2.2.4 Regulatory forbearance

More recently, scholars have studied whether political connections affect the regulatory process. Studies of how political connections may benefit firms as they interact with regulators are particularly challenging to interpret, as it is difficult for the researcher to observe both the objective benchmark for regulated behavior and a firm's potential deviation from this benchmark. Nevertheless, a number of studies have shown that political connections help firms delay or reduce sanctions, and a smaller number show that politically connected firms reduce compliance with government laws.

One branch of the literature focuses on the enforcement of rules designed to protect shareholders. Correia (2014) finds that firms that have made campaign contributions or lobbied are less likely to face an SEC enforcement action and face lower penalties, while Yu & Yu (2011) find that firms' lobbying expenditures influence the time between a fraud occurring and its detection by the SEC. Mehta & Zhao (2020) find that firms located in important politicians' districts face less scrutiny from the SEC but are punished by voters when there are enforcement actions that adversely affect local employment This suggests that there are limits to political interference in SEC enforcement. Other work has shown that politically connected *executives* face fewer government sanctions for actions taken against the interests of shareholders (e.g., Bourveau, Coulomb & Sangnier, 2021; Fulmer, Knill & Yu, 2023).

Another branch of the literature focuses on government oversight of corporate behavior that affects other stakeholders. For example, Heitz, Wang & Wang (2021) find that politically connected

firms experience fewer EPA violations than unconnected peers. Fisman & Wang (2015) find that worker mortality is higher in Chinese firms that have connections to local governments. Baker, Frydman & Hilt (2023) and Mehta, Srinivasan & Zhao (2020) show that administrative discretion and political connections impact merger outcomes. Most of the work that examines political connections and regulatory forbearance holds firm behavior constant and examines the likelihood of enforcement conditional on that behavior. One exception is Akey, Heimer & Lewellen (2021), who show that banks reduce compliance with fair lending laws such as the Community Reinvestment Act when their home state Senator becomes chair of a committee, particularly committees overseeing the agencies that enforce such laws.

2.2.5 Operationally relevant policy information

Finally, other studies show that political connections provide firms with operationally-relevant policy information.[4] For example, Ovtchinnikov, Reza & Wu (2020) find that politically connected firms are more innovative because their connections provide them with information that allows them to preferentially position themselves to react to industry deregulation events. Gao & Huang (2016) find that hedge funds that hire lobbyists outperform funds that do not. Moreover, recent work shows that political connections allow firms and analysts to better forecast and contextualize policy-relevant information (Christensen, Mikhail, Walther & Wellman, 2017; Christensen, Morris, Walther & Wellman, 2023).

2.3 The Costs of Political Connections

An emerging literature studies the costs that political connection can impose on firms. For example, Faccio & Hsu (2017) find that politically connected private equity firms reduce employment at portfolio companies by less than their unconnected peers. Smith (2016) finds that local corruption in the US is associated with reduced corporate cash holdings and increased debt issuance. Bradley, Pantzalis & Yuan (2016) find that state pension funds overweight holdings of local firms

[4]This literature is distinct from the literature that studies whether lobbyists are more likely to provide useful information to policymakers or to engage in capture (Blanes i Vidal, Draca & Fons-Rosen, 2012; Bertrand, Bombardini & Trebbi, 2014).

that are politically active and that this overweighting is associated with reduced portfolio performance. Bertrand, Kramarz, Schoar & Thesmar (2018) find that politically connected firms increase employment in politically contested areas during election years and that such firms are less profitable. Political connections can also prove costly to firms in periods of political upheaval. For example, Acemoglu, Hassan & Tahoun (2018) find that Egyptian firms with ties to groups vying for power during the Arab Spring lost value as protests decreased the likelihood that their group would remain in power.

Other work studies the costs of political connections for other stakeholders and the social costs of political connections. For example, Akcigit, Baslandze & Lotti (2023) find that political connections increase firm survival rates but decrease innovation among Italian firms. Complementing these findings, Grotteria (2024) develops a structural model of lobbying and shows that lobbying decreases American firms' incentives to invest in R&D. Schoenherr (2019) finds that politically connected firms in South Korea benefit from preferential access to government contracts and that these contracts perform poorly, leading to reduced economic activity. Fisman & Wang (2015) show that worker deaths increase in Chinese firms after they become more politically connected. We believe that there are many open questions about the costs of political connections for both firms and society and look forward to more research in this area.

3 BANKS

Banks provide capital and services to other types of firms. They are a primary source of funding in market economies and in most countries play a central role in economic growth. Because of their location at the nexus of economic activity, banks are heavily regulated and often have deep connections with politicians. The literature shows that political connections often distort banks' capital allocation and connected banks often influence the bank regulatory process in their favor.

3.1 Political Connections and Bank Lending

A long literature has shown that political connections can improve firms' access to loans and other forms of intermediary capital. The majority of this literature has focused on intermediaries as a

mechanism through which politically connected firms can obtain cheaper or more plentiful access to finance (see, e.g., Khwaja & Mian, 2005; Claessens et al., 2008; Houston et al., 2014). Lenders may provide increased credit access because (1) connected firms are perceived as lower-risk, or (2) due to direct interference from politicians. There is evidence for both channels. There is also evidence that banks sometimes refrain from providing credit when they feel politically protected and the credit in question is mandated by law, not economics (Akey et al., 2021).

Like firms, intermediaries can be connected to politicians through campaign contributions, lobbying, revolving-door hires, interest groups, geographic ties, and other mechanisms. For example, Schroedel (1986) and Kroszner & Stratmann (1998) examine banks' campaign contributions, Igan, Mishra & Tressel (2012) examine lobbying by banks, and Braun & Raddatz (2010) examine connected bank directors, among others. The literature generally finds that state-owned banks and other politically-connected banks lend more ahead of elections and provide increased access to credit to politically-connected firms or to politically-expedient sectors, often at the expense of other worthy creditors, despite such loans having higher default rates (Sapienza, 2004; Dinç, 2005; Khwaja & Mian, 2005; Claessens et al., 2008; Carvalho, 2014; Liu & Ngo, 2014; Koetter & Popov, 2020; Kumar, 2020). In return for making such politically-motivated credit decisions, connected lenders receive regulatory relief (Lambert, 2018) and government financial assistance (e.g. Duchin & Sosyura, 2012; Chavaz & Rose, 2019) that are not available to non-connected banks.

3.2 Political Connections and Bank Regulation

The literature also finds that politically connected banks can bend banking regulation in their favor at the expense of citizens and other interest groups (see, e.g., Johnson & Kwak, 2010). Benmelech & Moskowitz (2010) show that state usury laws in the 19th century were constructed to protect incumbent banks from entry. Kroszner & Strahan (1999) find that politically powerful banks significantly influenced the path of bank deregulation in the United States and congressional voting on deregulation-related legislation. Similarly, Igan & Mishra (2014) find that connected banks influenced financial regulation ahead of the 2007-2008 financial crisis. Bian, Goraya, Haselmann, Kick & Vig (2020) show that the centralization of political decision-making can also influence

government interference in banking markets, with local politicians obtaining more private benefits from interference than the central government. Collectively, these papers suggest that powerful banks can often co-opt or bend regulation in ways that provide them with barriers to entry, lower costs of capital, and other significant benefits relative to rival firms.

4 MARKETS

Politics and politicians also affect financial markets. Much of this work is international in context and is covered in the following section. This section primarily focuses on studies related to the links between politicians and the US stock market.

4.1 Political Risk Premia

The political risk faced by firms is reflected in market prices. Theoretically, Pástor & Veronesi (2012, 2013) show that the announcement of new government policies will on average reduce stock prices, with the magnitude an increasing function of how much uncertainty there is about future policy. Uncertainty also leads to risk premia in stocks whose magnitudes are larger during downturns. Policy changes and high political uncertainty are expected to increase comovement among stocks. Building on this literature, Grotteria (2024) proposes another explanation for political risk premia: namely, that lobbying can improve a firm's market position and rents, but that political competition and government policy shocks can combine to reduce firms' rents precisely when marginal utility is high, thus producing a risk premia and discouraging investment in innovative activities.

There is strong empirical support for these predictions. Brogaard & Detzel (2015) find that high political uncertainty is associated with higher subsequent stock returns. Hassan, Hollander, van Lent & Tahoun (2019) create a firm-specific measure of political risk and find that political risk is priced in the cross-section of stocks. Kelly, Pástor & Veronesi (2016) examine the pricing of options that straddle election dates and show that options spanning the election date (thus providing "insurance") are significantly more expensive than options expiring just before the election. Akey & Lewellen (2017) combine this uncertainty literature with the literature on individual firms' political connections and find that the marginal value of a political connection is largest for firms whose

stock prices are the most sensitive to changes in policy uncertainty. Finally, Grotteria (2024) presents evidence consistent with his empirical predictions: high-lobbying firms earn significantly higher stock returns than low-lobbying firms, and these higher costs of capital lead to reductions in innovative activity that likely harm the economy.

4.2 Political Cycles and Stock Returns

A separate literature has examined partisan political cycles and their effects on stock returns. This literature is built around the surprising empirical regularity that US stock returns are higher during Democratic presidencies than Republican presidencies on both a raw and risk-adjusted basis (Santa-Clara & Valkanov, 2003). Theoretically, Pástor & Veronesi (2020) argue that this regularity can be explained by the timing of when Democrats and Republicans are elected: Democrats (pushing redistributive policies) are elected when risk aversion is high, leading to high stock returns during Democratic presidencies. They find empirical support for this prediction (see also (Miller, 2025)). Political cycles have also been shown to exist in the cross-section of firms. Belo, Gala & Li (2013) find that firms highly exposed to government spending shocks have higher cash flows and stock returns during Democratic presidencies. Addoum & Kumar (2016) show that stock returns in "partisan" industries vary predictably over political cycles due to demand-driven trading, with (say) Democrats rushing to buy healthcare stocks when Democrats come to power. Collectively, these papers suggest that the political ideology of the party in power matters for asset returns.

4.3 Information Flows and Investor Returns

A third and final literature examines information flows between politicians, firms, and investors, and shows that politically-informed investors often profit from their access to information. For example, Gao & Huang (2016) show that hedge funds that form connections with lobbyists outperform their benchmarks when trading in connected stocks. Similarly, Jagolinzer, Larcker, Ormazabal & Taylor (2020) find that politically-connected corporate insiders made unusually profitable trades during the 2007-2009 financial crisis, consistent with an insider trading explanation.[5] However,

[5]Interestingly, conclusions are mixed on whether politicians themselves profit materially from their own inside knowledge (see, e.g., Ziobrowski, Cheng, Boyd & Ziobrowski, 2004, Eggers & Hainmueller, 2013, and Cherry, Heitz &

markets are sometimes slow to pick up value-relevant political information. For example, Cohen, Diether & Malloy (2013) document that informed politicians' voting records contain market-relevant information for affected firms, but that markets are slow to incorporate this information into stock prices. Overall, these papers provide evidence that asset returns are sensitive to information about political events and that politically-informed traders often profit from such information.

5 HOUSEHOLDS

A growing body of literature studies whether partisan beliefs shape economic expectations and the real economic decisions of individuals and households.

5.1 Partisan Alignment and Economic Expectations

Research in political science shows that individuals' economic expectations are shaped by partisan alignment (see for e.g. Bartels, 2002), and political affiliation is systematically correlated with household economic outlook (Hong & Kostovetsky, 2012; Huberman, Konitzer, Krupenkin, Rothschild & Hill, 2018; Mian, Sufi & Khoshkhou, 2023). The central question is whether such expectations are simply a reflection of "partisan cheerleading" or whether they reflect improved economic circumstances for those households.

Studies have found that partisan identity influences expectations about economic conditions without any change in individual economic circumstances. For example, survey evidence following the 2016 Brexit referendum, the 2016 US Presidential election, and the 2018 UK parliamentary vote shows that individuals who voted for the winning side become more optimistic about the stock market (Huberman et al., 2018). Using the University of Michigan Survey of Consumers and Gallup, Mian et al. (2023) find that individuals aligned with the President's political party express systematically more optimistic expectations than those aligned with the opposition party, and this partisan gap in economic expectations has become larger over time. However, despite these partisan differences in economic expectations, neither study finds corresponding effects on

Jens, 2017, though Stephan, Walther & Wellman (2021) provide evidence that connected politicians may be receivers of insider trading tips from brokerage houses.

individual consumption behavior. In particular, examining tax rates, personal income growth, and transfers around elections, Mian et al. (2023) observe that economic circumstances do not improve more in areas supporting the new President.

Other research suggests that partisan economic optimism can shape real household decisions beyond stated expectations. Gerber & Huber (2009) report that counties with a higher vote share for the President experience higher levels of consumption, suggesting that partisanship influences spending. Extending the analysis to entrepreneurship, Engelberg, Guzman, Lu & Mullins (2025) show that Republicans are more likely than Democrats to start new firms, and that this partisan entrepreneurship gap responds to the party in power in the White House, narrowing after a Democratic presidential victory and widening after a Republican victory.

Below we describe the evidence on partisan beliefs and the financial decisions of households.

5.2 Household Politics and the Stock Market

Recent studies examine how household political beliefs affect stock market participation and portfolio choice. Kaustia & Torstila (2011) show that left-leaning Finnish investors are significantly less likely to own stocks, even after controlling for wealth, income, and risk aversion, and Ke (2024) documents that US investors aligned with the Democratic party are less likely to participate in the stock market than investors aligned with the Republican party. Bonaparte & Kumar (2013) find that politically active households are more likely to participate in the stock market, attributing this to lower information costs.

Beyond participation, partisan economic expectations also appear to affect portfolio allocation. Bonaparte, Kumar & Page (2017) show that investors tilt more heavily toward equities and riskier stocks when their preferred party holds power, and reduce exposure to these assets when it does not. Extending this research, using the surprise outcome of the 2016 US presidential election, Meeuwis, Parker, Schoar & Simester (2022) find that investors in the most Republican zip codes increased their equity share relative to those in the most Democratic areas, and attribute this divergence to partisan differences in expectations about macroeconomic conditions.

Building on evidence that partisan beliefs shape investor behavior, recent work shows that

partisan beliefs generate disagreement among retail investors (Cookson, Engelberg & Mullins, 2020; Goldman, Gupta & Israelsen, 2024; Sheng, Sun & Wang, 2024). Using the COVID-19 pandemic as a shock to uncertainty and measuring partisan beliefs from the political posts of StockTwits users, Cookson et al. (2020) find that Republican investors were more optimistic than non-Republicans after the outbreak, more positive on hard-hit US stocks but more pessimistic on Chinese firms, and that such disagreement increased market-wide turnover. Goldman et al. (2024) demonstrate that partisan disagreement in the coverage of corporate news leads to increased trading volume. Sheng et al. (2024) find a partisan gap in stock returns between firms likely dominated by Republican (red stocks) and Democratic (blue stocks) investors during the Covid-19 pandemic driven by polarized political beliefs about Covid.

The influence of partisan beliefs extends beyond financial markets to housing choices. Consistent with the evidence of widespread partisan segregation in the US (Brown & Enos, 2021), using home sales records and voter registration data from North Carolina, McCartney, Orellana-Li & Zhang (2024) show that homeowners are more likely to move if their neighbors do not share their political beliefs. Comparing the likelihood of home sales among current homeowners whose new neighbor is affiliated with the opposing political party to that of other homeowners in the same neighborhood with new neighbors not affiliated with the opposing party, the former group is more likely to sell their homes than the latter. Bernstein, Billings, Gustafson & Lewis (2022) find that partisan residential sorting may also occur due to differing political views on climate risk. Comparing homes in the same zip code and similar elevation or proximity to the coast, they find that homes exposed to long-run sea level rise risk are more likely to be owned by Republicans rather than Democrats, and this partisan residency gap increases over time.

5.3 Household Finances and Political Behavior

The canonical view in the political science literature is that voters reward or punish the incumbent party based on recent economic performance (see for e.g., Kramer, 1971), or as US political analyst James Carville memorably put it, "it's the economy, stupid." Since Stigler (1973) challenged the robustness of this "economic voting" model, the literature has debated whether voting reflects

national economic views (Kinder & Kiewiet, 1979) or personal financial circumstances (for e.g., Healy & Lenz, 2017), and whether shocks to household balance sheets influence who votes rather than how they vote (Hall, Yoder & Karandikar, 2021; McCartney, 2020).

Using credit bureau data on consumer loans in California, Healy & Lenz (2017) show that communities with the highest delinquencies during the subprime crisis shifted against the incumbent President's party in 2008, although Hall et al. (2021) find that home foreclosures lower turnout but do not affect the incumbent party's vote share. Contributing to this literature, McCartney (2020) also finds that declining home prices and foreclosures reduce voter turnout. This contrasting evidence suggests a nuanced impact of household finances on political behavior. Lastly, individuals in regions with greater industry clustering contribute more to politicians with jurisdiction over that industry, suggesting that personal finance considerations may lead to strategic political behavior on the part of local households (Ovtchinnikov & Pantaleoni, 2012).

6 INTERNATIONAL CAPITAL FLOWS

Bilateral political relations, geopolitical tensions, political preferences of intermediaries, and political connections can shape cross-border capital flows, financial access, and financial reforms. In this section, we summarize the evidence on their effects on foreign direct investment, portfolio flows, lending, cross-border M&A, and reforms, and highlight open questions about channels and efficiency.

6.1 Cross-border Political Relations and Global Capital Flows

Recent geopolitical events such as the US-China trade war, Covid-19, war in Ukraine, and US tariffs on major trading partners have further highlighted the importance of political relations between countries in shaping international trade and investment flows. For example, then-Secretary of the Treasury Janet Yellen argued in 2022 that rather than relying on countries with which the US has geopolitical frictions, firms should move towards "friend-shoring" of supply chains to trusted countries.[6] Similar arguments have been made by the European and Chinese governments.

[6] https://home.treasury.gov/news/press-releases/jy1872.

Motivated by these policy shifts, the literature has studied whether "political distance", typically proxied with UN General Assembly voting alignment, shapes bilateral capital flows between those countries (se for e.g., Gupta & Yu, 2007; Gopinath, Gourinchas, Presbitero & Topalova, 2025). In particular, Gopinath et al. (2025) show that since the start of the war in Ukraine, worsening bilateral political relations are associated with significant declines in FDI and portfolio flows between countries in geopolitically distant blocs, relative to flows between countries within the same bloc. Not all investors respond alike, for example Knill, Lee & Mauck (2012) show that sovereign wealth funds lean against political affinity, perhaps for diversification reasons. Relatedly, Ambrocio & Hasan (2021) observe that countries with better political relations with the US have higher ratings and lower yields for their sovereign bonds. Examining the influence of bilateral political relations on firms, Fisman, Hamao & Wang (2014) find that Japanese companies with greater exposure to China and Chinese companies with more Japanese exposure, experience relative price declines in response to adverse shocks to Sino-Japanese relations. Beyond country-level political relations, the political beliefs of financial intermediaries also influence cross-border capital flows, such as syndicated corporate loans and international equity mutual fund flows (Kempf, Luo, Schäfer & Tsoutsoura, 2023).

The literature has shown that the likelihood of cross-border M&A deals are influenced in part by bilateral political relations (Dinç & Erel, 2013; Bertrand, Betschinger & Settles, 2016; Aleksanyan, Hao, Vagenas-Nanos & Verwijmeren, 2021). In particular, there is widespread evidence of economic nationalism in European Union cross-border M&A deals (Dinç & Erel, 2013); decreasing political affinity increases the likelihood that host country governments will intervene in a merger decision (Bertrand et al., 2016); and, state visits are associated with a higher likelihood that corporations from visiting countries will acquire corporations in host countries (Aleksanyan et al., 2021). The recent increase in national security screening of cross-border M&A deals in the US and Europe is likely to further affect these investments.

Taken together, these results raise a central question: are the effects of politics on global capital flows driven by heterogeneity in economic expectations about macro-economic conditions, perceptions of increased political risk, or nationalism?

6.2 Political Relations and Cross-border Banking Flows

Geopolitics also affect international banking sector flows. Bilateral diplomatic frictions and distance can show up in loan prices and volumes of syndicated loans (Ambrocio, Gu, Hasan & Politsidis, 2022), and recent work finds that higher geopolitical tensions significantly dampen cross-border bank lending and amplify the transmission of monetary policy (Pradhan, Stebunovs, Takáts & Temesvary, 2025). Garmaise & Natividad (2013) examine how changes in international bilateral political relationships that generate shocks to the cost of financing for microfinance institutions affect lending behavior.

Studying banks' sovereign bond holdings, the literature finds evidence of a sovereign–bank feedback loop. Sovereign stress or default erodes bank net worth and reduces private credit, while bank rescues raise sovereign risk (Gennaioli, Martin & Rossi, 2014; Acharya, Drechsler & Schnabl, 2014). In the euro crisis, banks increased the home bias of their sovereign portfolios and governments used moral suasion to steer domestic banks toward home-country sovereign debt, crowding out corporate lending (Battistini, Pagano & Simonelli, 2014; Altavilla, Pagano & Simonelli, 2017; Becker & Ivashina, 2018; Ongena, Popov & Horen, 2019).

Whether the dramatic shift in geopolitical alliances since the Ukraine war and the second Trump presidency will further contribute to geo-economic fragmentation in capital markets remains an open question.

6.3 Political Economy of Financial Development

A large finance literature has studied the effects of capital account liberalization (Henry, 2000; Chari & Henry, 2004; Bekaert, Harvey & Lundblad, 2005; Gupta & Yuan, 2009), and privatization (Megginson & Netter, 2001; Gupta, 2005), on the cost of capital and economic growth. At the same time, which reforms are enacted and when is likely to be influenced by the political power and rent-seeking motives of incumbents and politicians (Biais & Perotti, 2002; Rajan & Zingales, 2003; Stulz, 2005; Chari & Gupta, 2008; Dinç & Gupta, 2011). For example, studying FDI liberalization, Chari & Gupta (2008) show that highly concentrated industries and those with large state-owned firms are less likely to allow foreign investment. On the political economy of privatization, Biais & Perotti

(2002) argue that strategic privatization by right-wing governments can shift political preferences away from left-wing parties, and Dinç & Gupta (2011) show that Indian state-owned firms located in politically competitive areas are less likely to be privatized, and that no firm located in the home state of the minister in charge is ever privatized.

7 OPEN QUESTIONS

While the literature on the political economy of finance has expanded rapidly in recent decades, there is still much to explore. At a high level, the literature would greatly benefit from papers that are well-identified, externally valid, and contribute to the theory of the political economy of finance. While we do not have space to present an exhaustive list, below we discuss a subset of new and promising areas of research in the politics and finance literature.

7.1 What Money Matters in Politics?

There is currently little research on whether different forms of corporate political activity (campaign contributions, lobbying, etc.) represent complements or substitutes. Exceptions include Akey (2015), who finds that the value of "direct" and "indirect" campaign contributions varies depending on whether firms engage in other types of political activity such as lobbying or revolving-door hiring, and Albuquerque et al. (2020), who find that *Citizens United* likely crowded out lobbying and campaign contributions. Questions about which types of political connections matter are particularly important in the wake of *Citizens United*, which fundamentally reshaped the use of money in politics.

7.2 What Theories Explain Equilibrium Firm-Politician Behavior?

Most theories of political economy tend to focus on abstract notions of interest groups and legislators (e.g., Grossman & Helpman, 1994; Shleifer & Vishny, 1994). Few involve firms. The nascent theoretical literature on the political economy of finance (see, e.g., Pástor & Veronesi, 2012, 2013; Pástor & Veronesi, 2020, 2021; Döttling, Levit, Malenko & Rola-Janicka, 2024; Grotteria, 2024))

primarily focuses on asset markets and households. We believe there are many opportunities for researchers to contribute theoretically to our understanding of firm-politician behavior.

7.3 When do Politicians Benefit from Political Connections?

While the literature has shown that most forms of political activity create benefits for firms, there is not much direct evidence of the benefits of political connections to politicians, and more generally, there is not much evidence on whether politicians exercise their power through shaping firm decisions (one exception is Bisetti, Lewellen, Sarkar & Zhao, 2025). We believe that there is still much that can be done to show what politicians gain from their connections to firms.

7.4 How Do Political Factors Affect Relational Contracts?

Recent studies show that the partisan identity of firms can influence business relationships, leading to partisan matching in supply chain relationships (Gupta & Homroy, 2025) and affecting global supply chain locations (Ayyagari, Gao & Ma, 2024; Kempf, Luo & Tsoutsoura, 2025). More research is needed to explore how politics affects relational contracting between firms, firms and investors, and firms and households.

7.5 How Does Political Ideology Affect Firm Behavior?

CEOs and firms are increasingly enmeshed in politics (Babenko, Fedaseyeu & Zhang, 2023) and take public political stances. Recent studies highlight that while the decision to engage in "CEO activism" might align with shareholder interests (e.g., Mkrtchyan, Sandvik & Zhu, 2024; Homroy & Gangopadhyay, 2025), it also comes with risks (Painter, 2025). In addition, firms' public stances do not always align with what they actually do (e.g., Bebchuk & Tallarita, 2022). Many open questions remain on how CEO, employee, and institutional investor political beliefs shape firm policies about ESG, debt, investments, and lobbying priorities.

8 CONCLUSION

We survey the academic literature on politics and finance. We begin by summarizing the literature studying the political economy of firms. The first branch of this literature asks two main questions: how do firms form political connections, and do such connections create value for shareholders? The conclusion from these studies is that firms establish political connections through many different means (campaign contributions, lobbying, director appointments, revolving-door hires, and geographic or educational ties) and that such political connections generally create substantial value for shareholders.

Several papers examine the various mechanisms through which firms benefit from political connections. Politically connected firms are better able to access government contracts and more easily able to obtain financing. They benefit from preferential regulatory treatment and are able to secure political intelligence relevant to their operations. There is also limited evidence that they cause legislators to change their voting behavior. The final branch of the firm-focused literature examines whether connections between firms and politicians impose costs on firms or other stakeholders. Studies in this area find that political connections can be costly to firms during periods of political uncertainty or when politicians face fierce political competition.

A related literature examines the relationship between politicians and capital providers, especially banks. Politically connected banks and state-owned banks are more likely to lend money to politically connected firms, even though such loans often have higher default rates. A separate literature has also shown that connected banks are able to influence the path of financial regulation in favorable ways. Given that banks are at the center of economy-wide capital allocation, politically-driven lending and regulatory distortions may lead to the misallocation of credit and may reduce overall economic growth.

The distortions and frictions caused by politicians and the political process also affect financial market outcomes. At the macro level, stock markets are affected by political cycles: in particular, US market returns are systematically higher during Democratic presidencies. At the firm level, businesses that are highly exposed to policy shocks or face higher levels of policy uncertainty also earn higher stock returns than other firms. At the investor level, information flows between

politicians and connected investors lead to higher investor level returns, though there is mixed evidence regarding whether politicians themselves profit from their inside information about policy and government spending outcomes.

Recent work on household finance shows that partisan identity shapes individuals' expectations about the economy and markets. Partisan beliefs influence stock-market participation, portfolio allocation, investor disagreement, entrepreneurship, and residential sorting. Evidence also links household balance sheets to political engagement. Together, these findings highlight how politics affects household risk-taking and finances, while household wealth, in turn, shapes political participation.

Lastly, rising geopolitical tensions have increased geoeconomic fragmentation, directing capital flows toward politically aligned blocs. Cross-country evidence shows that bilateral political distance influences direct and portfolio investments, cross-border M&As, and global bank and syndicated lending, while tensions dampen these activities. Effects vary by investor type, with sovereign wealth funds sometimes leaning away from political affinity for the sake of diversification. Open questions concern channels, whether these are driven by economic expectations, perceived political risk, or nationalism; the efficiency costs of geo-economic fragmentation; and whether "friend-shoring" policies change the geography of global capital allocation. We look forward to new research in an era of shifting geopolitical alliances.

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