

TRADING ON POLITICAL INFORMATION: THE COMMON
STOCK INVESTMENTS OF MEMBERS OF CONGRESS
2004-2007

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I. INTRODUCTION

Talk a bit about the rules and the concerns. The current pending bill is:

GovTrack.us. H.R. 2341–110th Congress (2007): Stop Trading on Congressional Knowledge Act, GovTrack.us (database of federal legislation) ;<http://www.govtrack.us/congress/bill.xpd?bill=h110-2341>; (accessed Nov 30, 2008)

The rules are described in Public (Self)-Service: Illegal Trading on Confidential Congressional Information Andrew George. in the bib files as: george2008.

II. TRADING ON POLITICAL INFORMATION

There exists surprisingly little research about the financial transactions of politicians and US Congressmen in particular. Boller (1995) examined the FDRs of 111 randomly selected Congressmen who traded common stocks in the 1991-1993 period. He found that 83 Members held investments in companies that were potentially directly affected by ongoing legislation.

Ziobrowski et al. (2004) conducted the most comprehensive study to date. They investigated the common stock investments of US Senators drawing upon a dataset of 6,052 sell and buy transactions for the years 1993 to 1998. In their data, trades were highly concentrated; about 30 Senators traded in each year and overall four Senators accounted for almost half of all transactions.¹ Ziobrowski et al. asked whether trading Senators outperform the market, focusing on long run abnormal returns. As a first step, they conducted graphical event study analysis comparing daily cumulative abnormal returns (CAR) in a 255 day window before and after the transaction dates. An approximate reproduction of their finding is presented in figure 1, which shows the CARs summed over all transactions.

¹Ziobrowski et al. matched transactions from the FDRs with returns data from the Center for Research and Security Prices (CRSP) database for common stocks traded in NYSE, AMEX, and NASDAQ. They noted that “the care used to fill out the reports varies widely. Some are typed, some are handwritten, some include monthly financial statements from their brokerage firms, and some use abbreviations and terms that are impossible to decipher. Thus extraction of the data was very difficult and despite our best efforts may have resulted in occasional errors.” (Ziobrowski et al. 2004, pg. 3). Since Senators reported the dollar volume of the transactions within broad ranges the authors used midpoints for the volume weighted analysis and capped all transactions above \$250,000. The ranges are \$1,001-\$15,000; \$15,001-\$50,000; \$50,001-\$100,000; \$100,001-\$250,000; \$250,001-\$500,000; \$500,001-\$1,000,000; and over \$1,000,000.

The figures indicates an extremely fortunate timing of the Senators' trades. Stocks that they sold experienced a 25 percent run-up in the CARs during the 12 month prior to the sell date and remained fairly flat thereafter. Stocks that they purchases showed the opposite pattern; CARs increased by only 3 percent prior to the buying date, but by almost 28 percent in the year following the transaction.

As a second step, Ziobrowski et al. also ran formal tests based on a monthly calender-time portfolio approach with the Fama-French three factor model and the Capital Asset Pricing Model (CAPM). Averaging over all transactions, they considered six portfolios: a trade-volume weighted and equally weighted portfolio of the buy transactions, a trade-volume weighted and equally weighted portfolio of the sell transactions, and a trade-volume weighted and equally weighted hedged portfolio in which the buy transactions were held long and the sell transactions were held short. They found positive abnormal returns for the buy portfolios and the hedged portfolios. The results for the hedged portfolios were also generally significant at conventional levels (except the Fama-French Alpha from the equal weighted portfolio). Stock purchased by Senators on average outperformed the market by about 85 basis points per month or even 97 basis points in the hedged portfolio. For the buy portfolios the results were significant for the Fama-French Alphas, but not the Jensen's Alphas from the CAPM. They also found negative abnormal returns for the sell portfolios. Stocks sold by Senators on average under-performed the market by 12 basis points, but the magnitudes were generally smaller and the results were not significant at conventional levels. In general, the alphas were much higher for the trade-weighted than the equal weighted portfolios indicating that Senators invested more heavily in the most profitable transactions. They also conducted some subgroup analysis and found no reliable differences between the returns for the investments of Democratic and Republican Senators. Moreover, stocks purchased by Senators with least seniority (in office less than 7 years) showed higher returns than those bought by Senators with the highest seniority (in office more than 16 years). They also reported that in separate tests abnormal returns vary widely across years, in particular they found no abnormal returns for the years 1997 and 1998 when trading

activity dropped in their sample (presumably due to the retirement of a few very actively trading senators).

Overall, Ziobrowski et al. concluded that their results show that Senators use a substantial informational advantage in their trading. The sheer magnitude of their findings seem stunning. As a rough comparison Barber & Odean (2000) who measured the common stock returns for a large sample of randomly selected household over the 1991 to 1996 period found that they under-performed the market by 12 basis points.

III. DATA

We obtained data from the annual FDRs of all 650 Congressmen that served between 2004 and 2007 from the Center of Responsive Politics (CRP).

The FDRs contain 50,049 financial transactions overall each recording the name of the traded asset, the transaction date, and the approximate value of the transactions. Values of the transactions are disclosed within ranges (\$1,001-\$15,000; \$15,0001-\$50,000; \$50,001-\$100,000; \$100,001-\$250,000; \$250,001-\$500,000; \$500,001-\$1,000,000; and over \$1,000,000).

3.40

We eliminated all transactions that were not securities (mostly real estate transactions and investments in bonds) and corrected a few faulty transaction dates. For the remaining 34,199 transactions we matched the name of each transaction to a ticker symbol (using Google Finance) and retrieved daily quotes from the Center for Research and Security Prices (CRSP) database. CRSP only covers companies that were traded on NYSE, AMEX, or NASDAQ, so this led to the exclusion of other exchanges and mutual funds. A very small number of companies listed on those exchanges did not return quotes, presumably because the ticker recently changed. Overall we ended up with 32,149 transactions, 14,978 sells and 17,171 buys. The transactions cover a total of XX unique companies, about XXX are listed on the NYSE, XX percent on AMEX, and XX percent on NASDAQ.

Descriptive statistics for the sample are shown in table 1 and figure 2 shows the cumulative distribution functions for number of transactions per Member. We see that about 28

percent of all Congressmen (24 percent of all Senators and 28 percent of House Members) report no trade in the 2004-2006 period.² Over all three years, the median number of trades (buys and sells) per Congressmen is 4, the median number of trades is 3.5 per House Member and 5.5 per Senator. Trades are fairly concentrated among a small group of very active traders. More than 90 percent of Congressmen have less than 100 trades overall. The top 17 traders (with more than 500 trades each) account for about 61 percent of all transactions. The distribution of the value of the transactions is also highly skewed. Overall about 75 percent are between \$1,001-\$15,000; 15 percent are within \$15,0001-\$50,000; 5 percent are within \$50,001-\$100,000; and 5 percent are larger than \$100,001.

3

IV. CONCLUSION

$$R_{p,t} - R_{f,t} = \alpha_i + \beta(R_{m,t} - R_{f,t})$$

²There are 8 Members who served in both the Senate and the House in our period.

³Notice that we do not consider privately held companies despite that the fact that there are several examples of links between private companies and legislators. Numerous such cases are listed in the Citizens for Responsibility and Ethics in Washington's annual reports (2005-2008) on the "Most Corrupt Members of Congress." See <http://www.crewsmostcorrupt.org/report>.

REFERENCES

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- Boller, G. (1995), Taking stock in congress. Published in *Mother Jones*, Sept Issue.
- Ziobrowski, A., Cheng, P., Boyd, J. & Ziobrowski, B. (2004), 'Abnormal Returns from the Common Stock Investments of the US Senate', *Journal of Financial and Quantitative Analysis* **39**(4), 661–676.

TABLES

Table 1: Frequency and Volume of Transactions by Congressmen

	Buys				Sells			
	2004	2005	2006	all	2004	2005	2006	all
total no. of transactions:	4803	4934	5241	14978	5626	5373	6172	17171
no. of transactions: less_than_15k	3420	3710	3893	11023	3981	4098	4876	12955
no. of transactions: 15k_50k	650	789	658	2097	783	852	703	2338
no. of transactions: 50k_100k	239	227	292	758	190	202	229	621
no. of transactions: more_than_100k	184	183	376	743	206	193	291	690
total transaction volume (US\$k):	115018	117310	181612	413941	133013	133480	171065	437558
no. of transactions: min.	0	0	0	0	0	0	0	0
no. of transactions: 1st qu.	0	0	0	0	0	0	0	0
no. of transactions: median	0	0	0	1	0	0	0	2
no. of transactions: mean	10	10	11	32	12	11	13	36
no. of transactions: 3rd qu.	2	2	2	11	3	3	4	12
no. of transactions: max.	364	427	609	1144	625	461	715	1420
trans. volume (US\$k): min.	0	0	0	0	0	0	0	0
trans. volume (US\$k): 1st qu.	0	0	0	0	0	0	0	0
trans. volume (US\$k): median	0	0	0	8	0	0	0	32
trans. volume (US\$k): mean	244	248	385	877	282	283	362	927
trans. volume (US\$k): 3rd qu.	32	32	32	200	32	48	64	222
trans. volume (US\$k): max.	26570	24940	79730	131200	22160	43410	54170	119700

Figure 1: Figure 1 from Ziobrowski et al. (2004): Daily Cumulative Abnormal Returns for Common Stocks Bought and Sold by US Senators 1993-1998 (approximate reproduction).

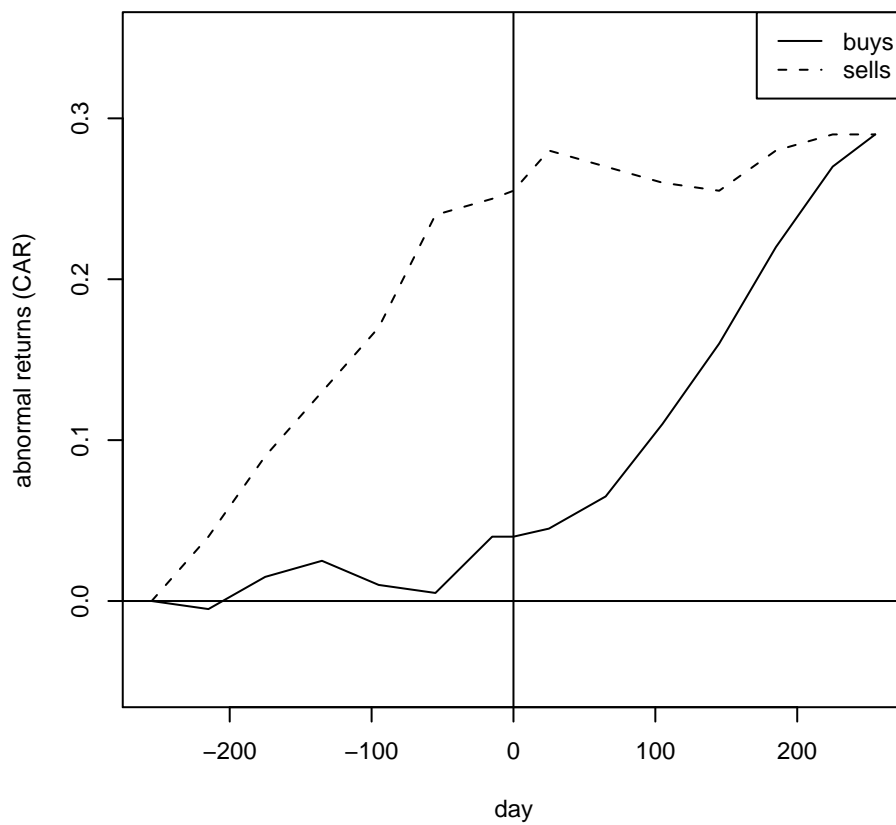


Figure 2: Cumulative Distribution Functions of Number of Transactions

