Columbia Business School

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Business and Politics: Which Drives Which?

A research symposium presented by the Sanford C. Bernstein & Co. Center for Leadership and Ethics at Columbia Business School and the Institute for Social and Economic Research and Policy at Columbia University
February 24, 2012

Bruce Kogut, the Sanford C. Bernstein & Co. Professor of Leadership and Ethics and director of the Bernstein Center at Columbia Business School, thanked conference guests and speakers.

Dean Glenn Hubbard, the Russell L. Carson Professor of Finance and Economics at Columbia Business School, delivered the closing remarks .

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In order of symposium agenda

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Introduction: Money, Influence, and Persuasion
By Bruce Kogut

There is no set of issues more puzzling and more important for a business school to consider than the relationship between politics and business. As a research institution, the Sanford C. Bernstein & Co. Center for Leadership and Ethics can shed light on this topic in a way that we do not often see in the news or in the halls of Congress. And there is probably no better time to have this discussion than now, when there is such a diversity of views. Yet politics is a difficult topic to discuss, whether over dinner or in the classroom. Possibly because the topic can be divisive, business schools tend to have few political scientists as faculty members and few courses on politics. It is equally possible that a business school would have little to gain and much to lose from teaching and researching politics, a topic sensitive to donors and to the ideological predisposition of students and faculty members, rather than to impartial consideration.

Yet we all know that politics matters deeply to economic outcomes and that business invests, with good reason, in persuasion and influence. Some scholars also have a predisposition to seeing that the problem lies with governments and their tendency to have "a grabbing hand." Others see business as the culprit, with its predilection for "the greasy palm." Neither metaphor gives much comfort.

Although emerging and sometimes developed markets provide substantial material to entertain a conference on the way business and politics interact, we chose to focus on the United States. Compared to the theatrics of Russia or India, this may seem an odd choice. Yet, the United States appears to many, inside and outside the country, as corrupted. It is common to point to the "revolving door" policy by which ex-government officials (including those in Congress and the military) are employed due to their expertise and influence or those in the private sector enter government. Yet, while this pattern has at least the virtue of attracting expertise, as noted by the *Financial Times'* US Managing Editor Gillian Tett, the more troubling of the legal and institutional trends in the US are the flood of large and polarizing contributions by a few wealthy individuals, often anonymous.

Why does politicking matter? In the context of today's debate, there is a wide sense that the historically extreme skew in income distribution that indicates the large share of income and wealth held by the few is evidence of a political process equally skewed by the politics of money. Our keynote speaker at this conference, Professor Raghuram Rajan of the University of Chicago, opened the day with a penetrating and balanced analysis that pointed more to the secular effects of globalization and technology for the vanishing middle class. Other speakers, such as Robert Kuttner, cofounder and co-editor of the *American Prospect*, or John Podesta, chair of the Center of American Progress, put politics more at the center. After all, though most developed countries have experienced growing income inequality, redistributive and allocative policies, such as public support for education, transportation, and housing, lead to widely different post-tax outcomes. Surely, some might surmise, the recent American Supreme Court ruling of Citizens United v. Federal Election Commission has promoted an uncomfortable joining of wealth and political influence. Whereas individuals cannot write checks directly to politicians, they can write checks indirectly via nonprofit organizations. From the perspective of these trends, income inequality is less about an argument of economic fairness versus entrepreneurial reward than the danger of concentrated economic and political power.

The research at the heart of this conference documented three channels of money and influence: lobbying, political advertising, and contributions. As discussed by the first panel, all three show considerable increases in the past decade. Is the finding discussed by Peter Stringham, CEO of Young & Rubicam, that the public holds in low regard all major political and economic institutions related to this ever increasing stream of better funded and divisive politics?

Our interest in this conference was not to document the influence of business and politics as more or less corrupt, either in fact or in public perception. To the contrary, for the effective creation of public policy, business and politics are often partners—first in understanding the issues, then in the design of the policy if not of the law itself, and finally in its implementation. Good policy is good implementation. Alice Rivlin reminded us over a preconference dinner that public policies require the participation of business, whether for defense or space exploration or for community development.

What solutions exist to develop a healthy business and government relationship? One solution is often the perennial favorite: less government—and with today's budgets, this almost seems a necessity. But would public-private partnerships be less vulnerable to corruption or wield less influence? Other solutions come to us from the technocrats, who are having their great day. But technocrats are neither impervious to politics, nor successful without sensitivity to political interests.

There is also the view, which I have argued, that business has not articulated well its case for the value it contributes to the well-being of society. Very few CEOs of major financial institutions have explained why a financial sector is critical to the health and growth of the economy. The polarization of business and government echoes the polarization in politics, perhaps a simple random coincidence, but more likely reflective of the failure of leadership on either side of these fences to build the coalitions needed to support farsighted policies. Conferences such as these are meant to provide forums through which such dialogue can help narrow the public and private gap. While universities and faculty members may occasionally also trip on potential corrupting influences of donations and external remuneration, to which *The Economist*'s US Business Editor and New York Bureau Chief Matthew Bishop alluded, unrestrained exchange of views is still a hallmark feature of the university.

The Bernstein Center is the focal point at Columbia Business School for ethics and leadership, including diversity and governance and these forums are designed to create the space for ideas and dialogues that universities are best able to provide. We have a lot of faculty members and researchers who work with us, and a lot of people and foundations who support us, and we are grateful to them. We would like to thank ISERP for its financial support of this conference, as well as my co-director Sandra Navalli, and the Bernstein Center's staff, Carolyn Tharp, Emily Moon, and Sahiba Anand, for all of their hard work that made this conference possible.


Raghuram Rajan, the Eric J. Gleacher Distinguished Service Professor of Finance at the University of Chicago Booth School of Business, delivered the opening keynote, "Have Capitalism and Democracy Been Captured by the Elite: Business and Politics Before the Crisis."

I. Have Capitalism and Democracy Been Captured by the Elite? Business and Politics Before the Crisis

In the last four years, the United States has seen a shift in the political sphere. Instead of short-term economic solutions and damage control in the wake of the financial crisis, the national conversation is now dominated by political rhetoric that has deepened the already pervasive sense of polarization. Peter Stringham, CEO of Young & Rubicam, noted in his keynote lunch address that this polarization has been disastrous for almost all institutional players; business, banks, and Congress have largely lost the public's trust. Possibly the only common ground is a growing sense among many policy experts that these divisions are hurting the country's chances of an economic recovery. As Alice Rivlin, senior fellow of economic studies at the Brookings Institution and a former vice chair of the Federal Reserve, said at a dinner preceding the conference:

> "Polarization leads to extreme policy proposals, which don't command a consensus, and therefore results in gridlock. In its own interest, business ought to be using its clout to drive politics back to the center—where all the viable solutions are."

But how should business push politics back to the middle? A current obstacle in accomplishing this goal is the widespread perception that the one percent has subverted the power of government and the markets. Are these divisions the result of a pervasive influence of business in politics? Or can we expect to bridge these differences as the financial crisis recedes further into the distance? "During good times, the elites don't have to exert their influence," noted Ray Horton, the Frank R. Lautenberg Professor of Ethics and Corporate Governance at Columbia Business School and a faculty leader of the Bernstein Center. "It is when the system goes into crisis that they exercise their power."

The financial and foreclosure crisis resulted in disproportionate suffering among the lower and middle classes, yet the government carried out an enormous bailout of the financial sector. Yet Raghuram Rajan, in his keynote presentation, disagreed with the notion that business interests are wielding unprecedented influence over the government.

> "When you look at the gains that the one percent received, starting in the 1990s and continuing through much of the 2000s, it does seem as if too much of the benefits of capitalism were going to the elite. But whether there has been any more political capture than in the past is debatable. We ask these questions about the elite because the elite has escaped relatively scot-free from the crisis, but that is a function of the way world economies function today—the elites are simply more protected. To some extent, the reason we are where we are today is that the answers that democracy gave to the problems of capitalism in the industrial West over the past 10 to 15 years have not been answers that led to sustainable capitalism."

A close analysis suggests that the policies that led to the crisis were not elitist in nature, he argued. The crisis unfolded in the spectrum of affordable housing: easy credit and low interest rates had fueled the subprime portion of the housing market, which primarily served low-income borrowers. "You could make an elitist argument that rapacious lenders were out to squeeze the very poor," Rajan said. "But it seems to me there are better targets to squeeze than the very poor if you want money." One reason the rapid expansion in the subprime market might have been tolerated for so long, he added, is that its orientation toward low-income borrowers was seen by many as democratic.

The origins of the crisis can be traced to the massive increase in societal promises, made to groups such as the elderly and the poor, in the high-growth 1960s. After the stagflation of the 1970s, policymakers in the 1980s turned to deregulation and financial liberalization as a way to encourage growth. However, the nation's education system failed to keep pace with its growing need for skills, resulting in greater income inequality. Easy credit was seen as a way for lower-income workers to keep up consumption.

In this same period, financial deregulation expanded the availability of capital and increased returns to the skilled and talented. And as the financial sector became deregulated, it needed people with more advanced skills. Soon, incomes in the sector were soaring. (See figure 1.)

As returns climbed for professionals with stronger skills and better education, those lower on the income distribution were experiencing the effects of a changed economy. By that time, many routine, unskilled jobs had disappeared. Routine skilled jobs were outsourced or lost to computers.

> "The safe, well-paying with good benefits jobs that were the mainstay of the middle-class are now gone. What that left were jobs at the extremes—very high-paying and very low-paying. It's not a given that you'll get more inequality. People can migrate. They can get the education and skills to get the high-paying jobs. But that doesn't happen. In the race between technology and education, education has lost. And because education is so hard to change over a lifetime, it is going to be even more entrenching as a source of inequality than anything else."

The fundamental roots of today's problems, he continued, are not political in nature; they are the results of sweeping macroeconomic changes: the effects of technology and of globalization. And these changes have created a new elite, one based on education, ability, and a degree of luck. Of greater concern than the wealth of one percent is the gap between those at the 90th percentile and those at the 50th percentile. (See figure 2.)

Some critics have argued that the financial sector has reaped excessive profits in recent years, contributing directly to the crisis, and that efforts should be made to reign in the industry. "That's a subversive notion, because we need a vibrant financial sector in order to have growth and innovation," Rajan said. Not that the world of finance is without blame—both before and during the crisis, there was a convergence between business and politics, which resulted in a cognitive capture: most of those who worked on solving the crisis were from Wall Street, and they did not seek solutions from outside of that circle.

If our problems lie not in a shortage of financial capital, but of human capital—talent and skills, then it follows that those who suffer the most are the nation's unskilled workers: the gardeners, the restaurant help, the home aides for the elderly. The United States needs to develop longer-term solutions, particularly on inequality in education, but polarization makes this difficult, Rajan said. "Electorates are impatient and divided, so politicians respond with short-term policies," he said. "Yet I have no doubt that eventually, we'll get it right. Democracy responds, and in time finds the right solutions."

To a significant degree, however, many researchers argue that business is wielding excessive influence in politics, to the public's detriment. In the next panel, four academics took a closer look at three ways in which money enters the political realm: through lobbying, advertising, and campaign contributions.

Relative Wage and Education in the Financial Industry

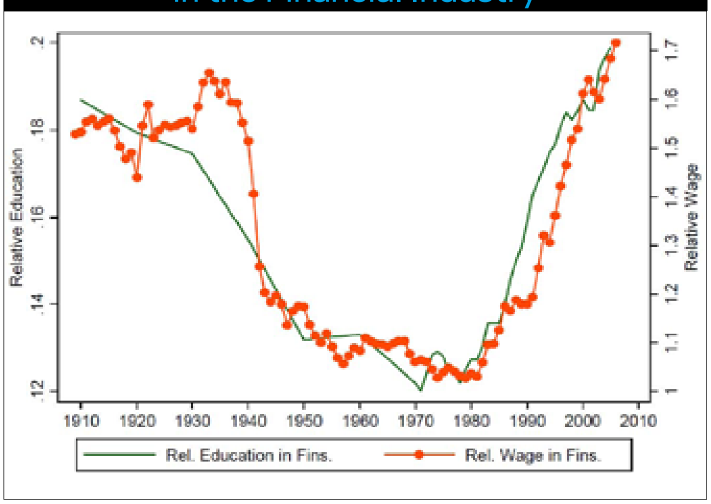

Figure 1: There was a strong correlation between wages and professionals with stronger skills and better education. Source: Philippon and Reshef (2009)

Consequence—Stagnating Middle in the United States

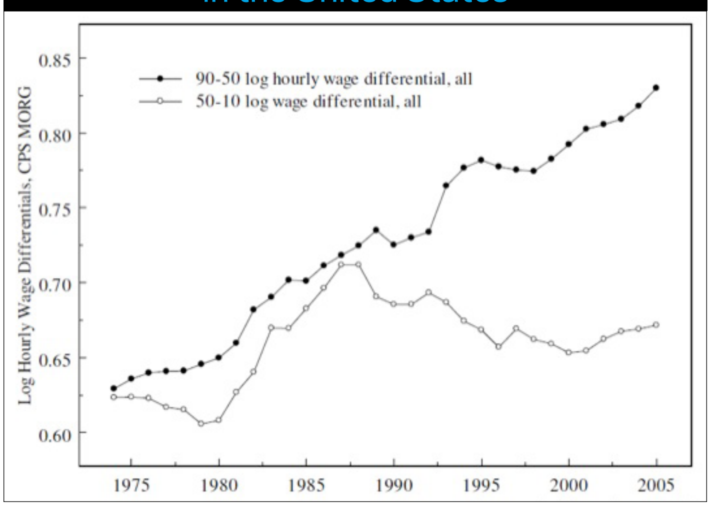

Figure 2: The growing gap between very high-paying and very low-paying jobs created a new elite, said Raghuram Rajan. Source: Golden and Katz (2009)

Conference guests speak during a break.

Marianne Bertrand, the Chris P. Dialynas Professor of Economics at the University of Chicago Booth School of Business, listened to the keynote speaker.

II. The Flow of Money into Politics

Money is flowing into politics, and it matters. That is the hypothesis proposed by Sharyn O'Halloran, the George Blumenthal Professor at Columbia University's School of International and Public Affairs, who moderated a research panel on the connections between money and politics. The amount of money spent on lobbying climbed to almost $3.5 billion in 2009 from just under $1.5 billion in 1998. During the same period, the number of lobbyists rose to almost 14,000 from about 10,000. The industries that are the most active in lobbying are healthcare and finance; within finance, the securities and insurance sectors are the biggest spenders. (See figure 3.) As O'Halloran noted:

> "It makes sense to assume that people are spending this money because they get something out of it. And you might imagine that this money is tilting the kind of policy outcomes we see toward the businesses and the classes that it represents."

Dollars Spent Lobbying and Number of Lobbyists, 1998–2009

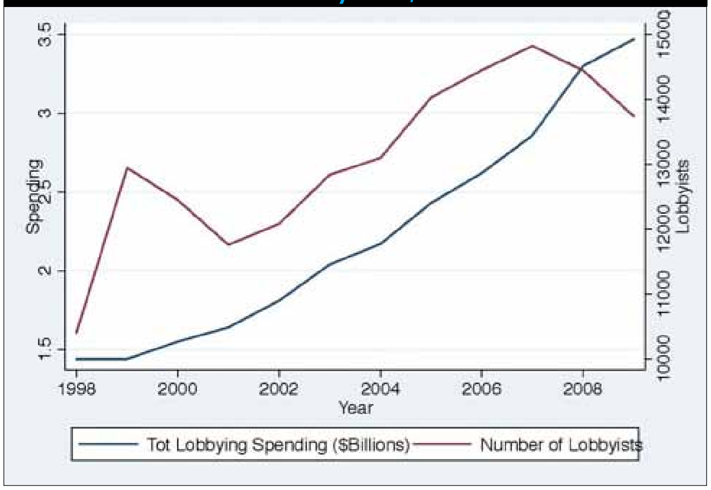

Figure 3: The amount of money spent on lobbying and the number of lobbyists grew significantly from 1998 to 2009.

Marianne Bertrand, the Chris P. Dialynas Professor of Economics and Richard N. Rosett Faculty Fellow at the University of Chicago's Booth School of Business, presented an empirical analysis of the lobbying process. Bertrand and her research partners first set out to gain a better understanding of what lobbyists do. One view, supported by the lobbying industry, is that lobbyists provide expertise through their deep knowledge of an issue or sector. The opposing view holds that lobbyists operate by leveraging connections to associates and friends in political power.

Using lobbyist records from the last decade, Bertrand and her coresearchers could determine how much individual lobbyists were paid and the issues the lobbyists represented. The researchers then developed proxies to measure the lobbyists' expertise and connections. They calculated expertise by a lobbyist's dedication to a particular issue: an expert or "specialist" spent at least one-quarter of his time on a single topic or industry. Campaign contributions served as a proxy for connections: if a lobbyist made a personal donation to a candidate, the researchers inferred a connection between the two. FEC records provided data on more than 144,000 individual political contributions by lobbyists over multiple years.

Once these proxies were established, the researchers compared the wage premiums of experts and non-expert lobbyists. They analyzed the importance of connections, in comparison to expertise, through a simple test: if a politician switched committees (and therefore issues), did the lobbyists connected to that politician switch issues as well? The researchers found little difference in the wages of expert and non-expert lobbyists. However, connected lobbyists earned a significant premium over non-connected lobbyists. And connected lobbyists were more likely to follow politicians when they switched committees.

Pursuing this idea further, the researchers analyzed whether the value of a politically connected lobbyist increases when the lobbyist's political party is in power. (Directories provide data on lobbyists' party associations. See figure 4.) This party-power link proved significant—at the peak of Republican power, Republican lobbyists earned a 25 percent yearly wage premium, the researchers found. As Bertrand concluded:

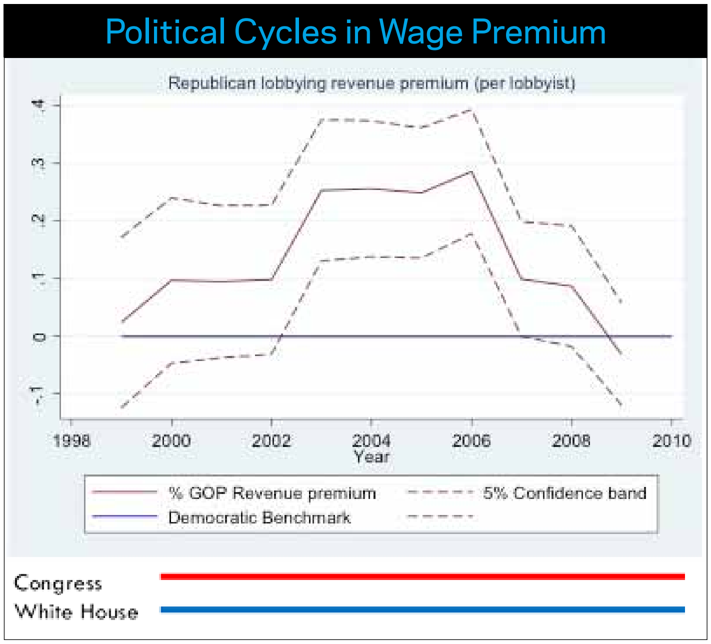

Figure 4: At the peak of GOP power, more than 25 percent was the yearly premium for GOP lobbyists.

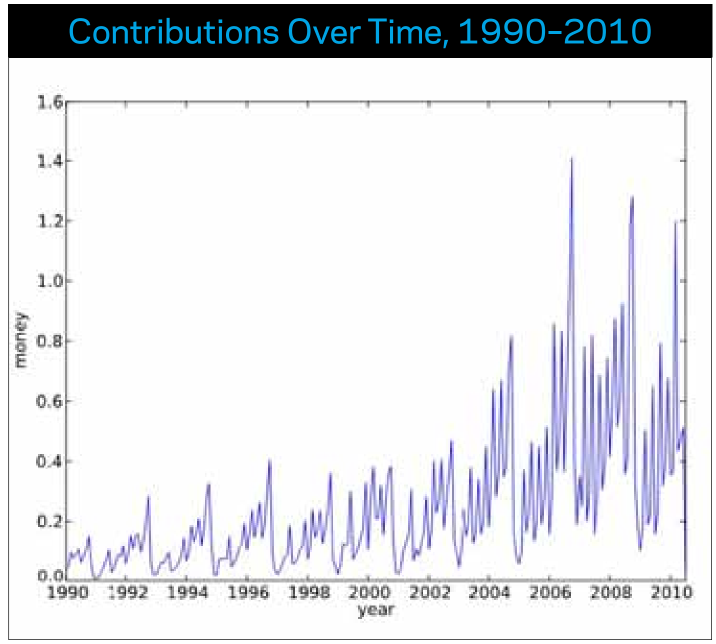

Figure 5: David Lazer of Northeastern University looked at campaign contributions and networks from 1990 to 2010. Source: Lin and Lazer (2010).

> "Consistently we find that connections are very valuable, and that they vary over political cycles in ways that are consistent. It seems that what determines what lobbyists work on is not what they know, but who they know."

The most significant—and, in recent years, increasingly controversial—way that money is pouring into politics is through campaign contributions. David Lazer, professor of political science and computer science at Northeastern University and director of the Program on Networked Governance at Harvard University's Kennedy School, explored the networks that link individual contributions. The social and organizational processes that direct money to politicians have changed considerably in the last few decades, most notably in the last few election cycles, with a dramatic uptick in 2004. (See figures 5 and 6.)

Republican and Democratic money comes from roughly the same places, yet there are significant regional inequalities. In Marysville, Kansas's 66508 ZIP Code, the per capita contribution was $4.71. In Manhattan's 10013 ZIP Code, the contribution was $178.48. "Contributing to campaigns is a mass elite phenomenon," Lazer said. Most individual contributions come from people in the top two percent of the income distribution. But the issue of population density is also important, and a key predictor of per capita contributions is the number of affluent individuals per square

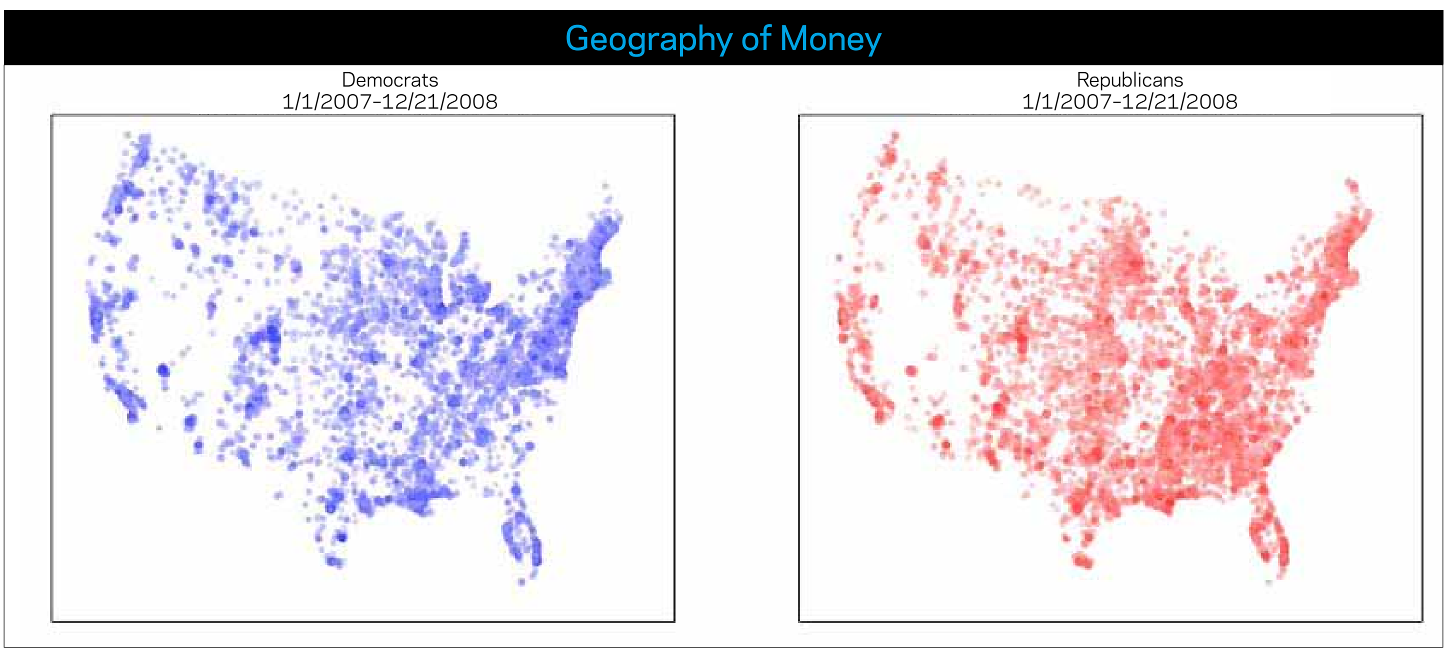

Figure 6: David Lazer of Northeastern University discussed from where in the United States Republican and Democratic money comes. Source: Onnela and Lazer (2009).

Bob Kuttner, cofounder and co-editor of the *American Prospect*, delivered closing remarks.

David Lazer, associate professor of the College of Computer and Information Science and Department of Political Science at Northeastern University, spoke about invisible networks of money in US politics.

mile; it is harder to raise money if the high earners are sparsely distributed. This population density factor tends to benefit Democrats. As Lazer said:

> "The affluent tend to tilt in a Republican direction, so any form of participation that requires money starts out with a Republican tint. However, the network dimension benefits Democrats, because population density is strongly associated with Democratic partisanship."

Lazer investigated connections in political-money networks by pairing individuals who made contributions on the same dates and to the same candidates. For example, if Person A gave money to four candidates on four dates, and Person B did the same, he inferred a link between A and B. Prominent pairs he uncovered included partners in lobbying firms, Hollywood moguls, and individuals who serve on the same corporate board. In cities such as Washington and New York, these networks are particularly elaborate. "Coordinated giving is a way of having a much bigger impact, and helps overcome some of the collection action issues inherent in campaigns," Lazer said.

His research also uncovered the importance of organizations to these networks. He studied data on individual contributions made by employees of Goldman Sachs and found that contributions to candidates tended to come on the same day. In one study, he showed that more than 50 percent of the contributions from people in Goldman Sachs came within the same week. "This highlights the importance of businesses in Manhattan in coordinating money to campaigns," he said. Given that candidates need to harvest money from geographically concentrated top earners, corporations are a prime setting in which to mobilize money.

How is the Citizens United decision changing this picture? Now, it seems, candidates need to cultivate a network of a few major contributors, rather than a network of many. In an interview, Lazer noted:

> "In the Republican primaries, the median dollar raised on behalf of candidates last month came from people writing seven-digit checks. There will be more emphasis on developing personal relationships with very wealthy individuals over many years, and geography will likely matter a lot less."

And how do candidates spend these donations? Brett Gordon, the Class of 1967 Professor of Business at Columbia Business School, explored a key outlet for these funds: political advertising. Spending on election advertising has doubled in each of the last four election cycles, with estimates of spending for the 2012 at close to $5 billion. (See figure 7.) This spending comes not just from candidates, but also parties, interest groups and, of course, super PACs. And it directed toward a relatively small portion of the nation's population: about 90 percent of all advertising reaches only one-third of voters. Outside of battleground states, voters are rarely targeted.

Presumably, as with the financial sector's spending on lobbyists, candidates believe this money is getting them something—in their case, more votes. To test this belief, Gordon conducted a thought experiment: who would have won the 2000 presidential election if there had been no advertising? Using data on advertising at the market level and voting outcomes at the county level, he used a model of voter behavior to estimate the effects of advertising on their decisions, such as whether to vote, and if so, for which candidate to vote.

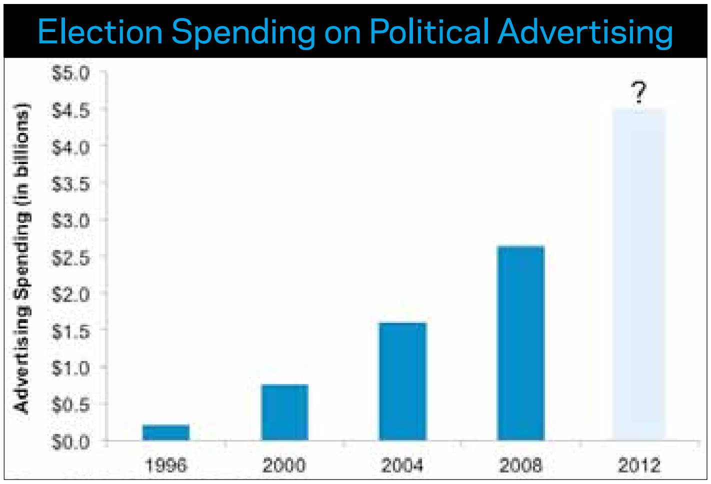

Figure 7: Spending on election advertising has doubled in each of the last four election cycles. Sources: PQ Media; *USA Today*, S&P Capital IQ.

Brett Gordon, the Class of 1967 Associate Professor of Business at Columbia Business School, discussed Political Advertising and the Electoral College.

Conference attendees listened to the session discussion.

He then took the model, which was based on observed levels of advertising, and set all of the advertising levels to zero. His model predicted that three states would have switched sides: Bush would have picked up Oregon, while Gore would have won Florida and New Hampshire. If only one had switched, the outcome of the election would have changed. Because the exercise involved many assumptions, he describes the results not as a strict prediction, but as a way of understanding the sensitivity of elections to advertising.

Are there ways to make this process less sensitive to ads? One common alternative to our current electoral college system is a direct popular vote. Gordon joined his voter model with a game theory model to measure how presidential candidates compete through advertising in the general election. The model considers how candidates allocate advertising simultaneously across many markets. After fitting the model to data from the 2000 and 2004 elections under electoral college rules, he changed the process to choose a winner according to a direct popular vote. He studied both how candidates' advertising strategies changed and how voters responded to the new advertising levels. The model showed that spending would have been more equitable, with more of the population targeted by advertising. At the same time, candidates would have advertised even more in their strongholds—which in turn would drive up total spending, since the cost of advertising on the stronghold East and West Coasts tends to be more expensive. How this would have changed the outcome? According to Gordon's model, Gore would have strengthened his win, picking up an additional 750,000 votes.

> "Political advertising can shift an election outcome. Moving to a popular vote puts all the states in play, which seems valuable since we want more people involved in the electoral process. But it would also likely increase the importance of fundraising for the candidates."

In the context of Raghuram Rajan's presentation, the research by Bertrand, Lazer, and Gordon presents a very different and stark picture of the current political climate: dramatic increases in political spending play against a backdrop of rising inequality. What is the relationship between these forces? Is inequality the result of macroeconomic forces, or is it tied to the increases in lobbying and political contributions? Shamus Khan, professor of sociology at Columbia University, made the case that rising inequality, with associated declines in mobility, is linked directly to the political process.

In a 1988 address to the American Economics Association, Gary Becker made his famous claim that "low earnings as well as high earnings are not strongly transmitted from fathers to sons"—essentially proclaiming that the American Dream was not mere rhetoric, but an empirically established fact. According to Khan, a great majority of citizens continue to believe that Becker was right: more than 80 percent say it is possible to move from poverty to riches through hard work. However, Khan argued, data shows that mobility in the United States is largely a myth; the United States has the second lowest mobility in the industrialized world, after the United Kingdom. (See figure 8.)

Take the example of a family at the poverty threshold. How long will it take for its descendants to reach within five percent of the national average on the income distribution?

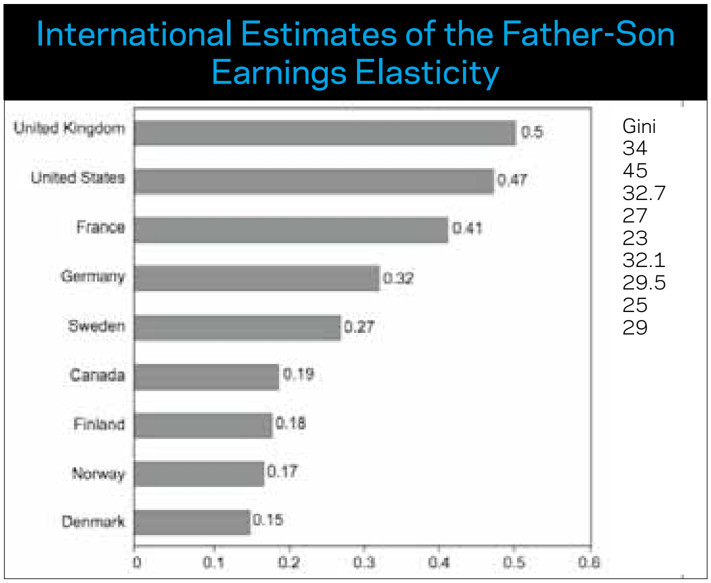

Figure 8: International estimates of the father-son earnings elasticity. Source: Corak (2004).

Shamus Khan, assistant professor of Sociology at Columbia University, who presented his research "Mobility and Inequality in the United States," spoke with conference guests during a break.

Conference guests spoke during a break.

Marianne Bertrand, the Chris P. Dialynas Professor of Economics at the University of Chicago Booth School of Business, discussed lobbyists and examined whether their connections pay off.

According to Becker's analysis, it should take fewer than two generations. But research by Khan and others suggests that it actually takes five or six generations, or 125–150 years: the chance of poor children becoming wealthy is incredibly low and the chance of rich children remaining rich is incredibly high.

In addition, hard work does not seem to pay off the way it once did. In the 1990s, households who worked more than 40 hours a week for two years in a row were more mobile than others in their income group. By the early 2000s, households that worked more hours did not experience an increase in mobility. "Working longer hours on a consistent basis no longer means you can reap the rewards of moving up," Khan said.

Therefore, rising inequality has not been offset by increases in mobility. But why has inequality increased so much? "It can be explained by changes in a very small sector: the fortunes of the rich have increased over the last 40 years," Khan said. "Inequality is increasing because wealthy people are becoming wealthier." (See figure 9.) Unlike Rajan, Khan argued that these changes were by design, linked directly to processes that began in the 1970s, under a Democratic president and Congress. The unraveling of progressive tax policies and regulations created a bias in distribution to the top. Business won the battle with labor, leading to a decline in unionization; about one-third of the rise in equality can be attributed to this drop. The financialization of the economy exacerbated these trends. Both parties supported business influence on political life, and therefore bear responsibility for the increase in inequality. As Khan concluded:

> "And you could worry about this rising inequality on strictly moral grounds. But you might also wonder about the sustainability of the nation in general—whether or not these income shifts have created instability in America and whether the data on low-income mobility signals a death of the American Dream."

In the question-and-answer session, Rajan asked why the political left spends so much time focusing on the one percent, when the divide between the 90th and 50th percentiles is at least as deserving of attention. "As a matter of policy, I certainly agree that we should think about what should be done about the vast majority of Americans," Khan responded.

Raghuram Rajan of the University of Chicago Booth School of Business spoke with Bob Kuttner of the *American Prospect* and Professor Tano Santos of Columbia Business School during a break.

Conference attendees spoke during a coffee break.

"But if you want to explain why the amount of inequality in the United States has increased since 1970, you need to look at the income share of people at the very top and the data that point to low mobility. It's not explained by other factors. There's a great shift in income from the vast majority of Americans to people at the very top of the distribution." He added: "I would turn the question around: Why is it so uncomfortable to talk about wealth or income policy?"

The answer to that question might be found in the increasing sense of polarization and the popular belief that business is benefiting from, and possibly encouraging, these societal divisions. The next panel explored how the public, increasingly skeptical of the wealthy, has largely lost its faith in business, large corporations, and government institutions.

III. How the Business of Politics Has Affected Business in America

In his keynote presentation, Raghuram Rajan discussed how more Americans are being left behind in perception, if not in fact. Yet the importance of perception should not be underestimated, as differences in perception are behind much of the polarization we see in politics and in society. Peter Stringham, the CEO of Young & Rubicam Group, spoke about how the financial crisis and the subsequent bailout have changed the public's perception of politicians and of business interests. "Business was winning for a while, and now it seems that it's losing," he said. "In the last twenty years, we have seen a shift from business driving politics to politics driving business."

The Occupy Wall Street movement, he noted, is fueled by a sense of frustration, which in turn arose from a widespread disintegration of trust. Young & Rubicam, a top advertising firm, has conducted extensive research on the disintegration of trust in brands, ranging from consumer products and companies to entities not traditionally thought of as brands, such as governments and countries. Using a tool called the Brand Asset Valuator, the firm found that the public's trust in

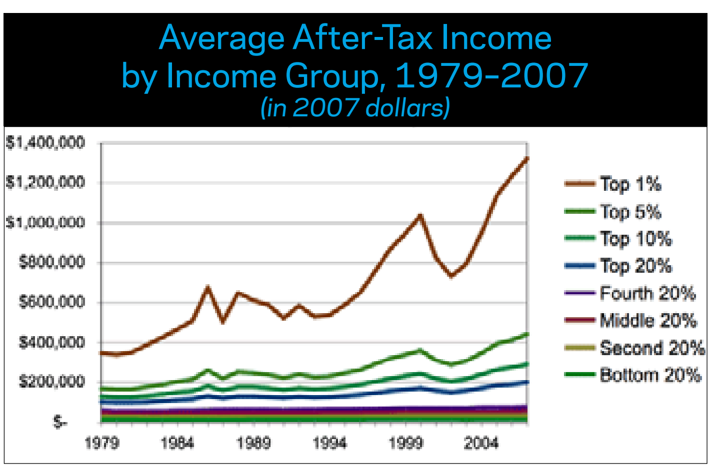

Figure 9: The fortunes of the rich have increased over the last 40 years, causing a rise in inequality. Source: Congressional Budget Office, Average Federal Taxes by Income Group, "Average After-Tax Household Income," June, 2010.

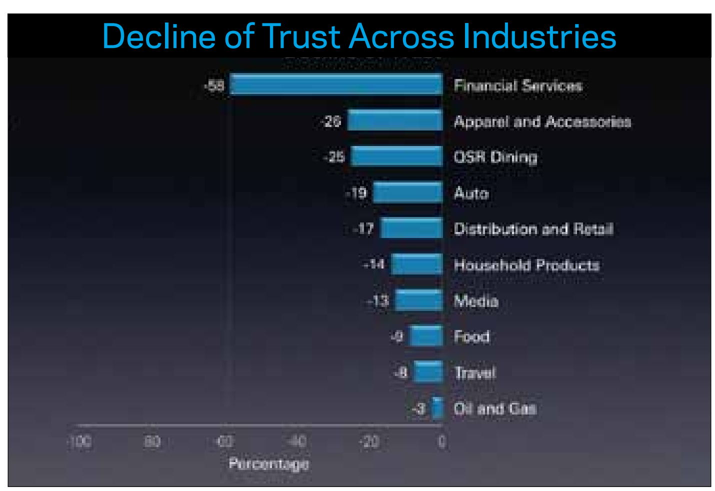

Figure 10: The public's trust in businesses across all industries fell dramatically in the wake of the economic crisis. Source: © 2011 by Young & Rubicam Group.

Peter Stringham, CEO of Young & Rubicam Group, delivered the lunchtime keynote address, "How the Business of Politics has Affected Business in America."

business fell dramatically in the wake of the economic crisis, with a loss of trust across all industries. (Not surprisingly, financial services took the greatest hit. See figure 10.) Of course, some industries fared better than others—the technology sector has retained its relatively strong reputation, but this is largely because tech firms are perceived as innovative and visionary, even if they are not seen as good corporate citizens, Stringham said.

The financial events and societal changes from the first quarter of 2008 to the end of 2009 perhaps made a loss of trust inevitable. Economic instability—in the form of unemployment, falling housing values, uncertain interest rates, bailouts, inflationary threats, and factory closures—sent destructive waves that directly affected consumer-corporate relationships. According to a Young & Rubicam study, the number of brands perceived as trustworthy fell by half in this period, the biggest drop in 20 years. Given that trust in a brand is usually very stable, and closely correlated to a brand's potential, companies soon realized the importance of repairing their reputations. (See figure 11.)

During this same period, the rising importance of social media also played a significant role in the loss of trust. As social media gained in stature, traditional media lost credibility as a source of trusted information. Businesses were soon struggling to catch up with this new media environment, with many finding themselves at the center of controversies they could not control. For example, when several banks announced that they would increase transaction fees, they instantly found themselves caught in a social media vortex of condemnation and quickly realized they faced a mass withdrawal of consumer accounts. Even a widely admired company like Apple found itself forced to respond to its labor issues in China after social media outlets disseminated news reports published by *The New York Times*. Increasingly, Stringham said, companies are taking active measures to monitor what is said about their firms in real time, and respond accordingly. And out of self-interest, these companies are also focusing more on corporate responsibility.

At this point, however, the public's view of large institutions remains decidedly negative. "It doesn't matter if you ask the elites or the general population," Stringham said. "All groups overwhelmingly disapprove of Washington. And the banks and Wall Street share the blame with the federal government." However, there is considerable divergence in the perception of corporations and of small businesses:

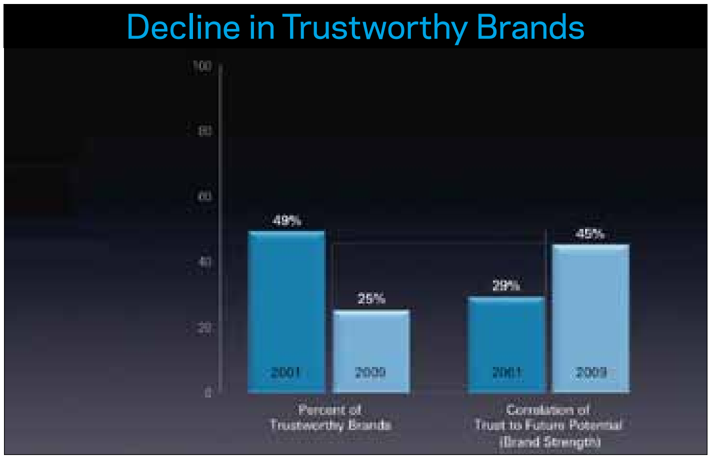

Figure 11: There are fewer brands people trust, so trust is now key to building brand equity. Source: © 2011 by Young & Rubicam Group. BrandAsset® Consulting: USA 2001, 2009 Full Year All Adults. Trustworthy brands defined as those with greater than 20 percent attribution.

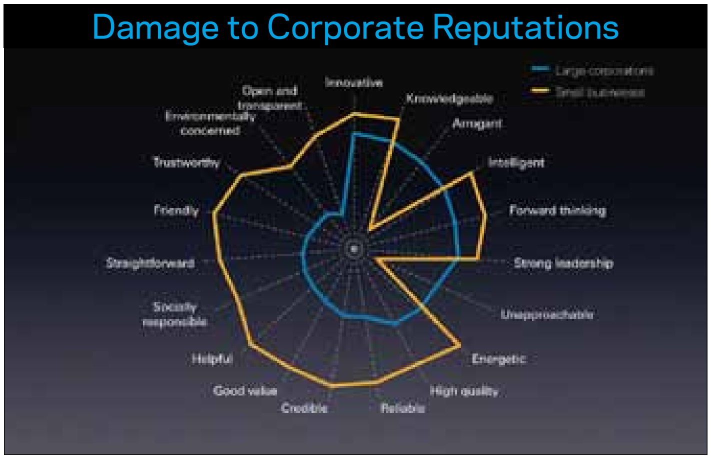

Figure 12: Corporate reputation has been damaged, with large disparaties between large corporations and small businesses. Source: Young & Rubicam Group. © 2012 Penn Schoen Berland LLC.

Conference guests listened to the keynote address.

> "Large corporations are seen as benefiting the most from political connections, while small businesses are perceived as never doing anything wrong. Ordinary Americans and small businesses are seen as having the least influence in Washington, compared to wealthy individuals and large corporations. The overwhelming perception is that government favors business over the public good. This is true even among elites—only 25 percent of the elite thinks the government works for the public good."

There is also a tremendous suspicion about corporate motives; according to Lake Research, a public opinion and political strategy firm, 88 percent of small business owners have a negative view of the role money plays in politics, suggesting they feel unable to compete with large corporations. (See figure 12.)

Significantly, many top firms outperform their industry averages on citizenship and have reaped the financial benefits. "Somehow, either by perception or reality, these companies are seen as better, and it makes a big difference to their brand strength," Stringham said. Yet even among those companies with the strongest reputations, citizenship continues to significantly lag behind performance. "Their reputations are pulling down their enterprise value. This isn't about being altruistic—their reputations are actually costing them money."

Today, businesses have entered a reactive mode and are more concerned about following politics than being able to influence politics, Stringham said. "There's been all this damage to reputations, and it's not going to self-correct and get better," he concluded. In the question-and-answer session, several members of the audience asked what businesses could do to improve their standing; one noted the problem of greenwashing, in which corporations promote small-scale "green" efforts in order to divert attention from their larger environmental problems. Businesses need to invest in long-term processes to improve their reputations as corporate citizens, Stringham replied. "You can't go out and make false claims," he said. "But business can take part in a dialogue with their critics and make real changes."

A conference guest posed a question to one of the speakers.

IV. A New Platform for Business and Government Interactions?

Much of the debate about the interaction between business and government is centered on a question of degree: Is business too involved in government, or too little? In a roundtable discussion, Glenn Hubbard, dean of Columbia Business School, said there is truth to both arguments.

> "There is too much involvement in the sense that there is often a great deal of business involvement in narrow provisions that might affect one company or a small set of companies. But business executives have also been very helpful in telling the government about what's going on in business, particularly at turning points such as 9/11 and the global financial crisis. You could say there are three roles for business in government: the good, the bad, and the ugly. The good is as a resource: a businessperson who contributes expertise, big ideas, leadership skills. The bad is the rent-seeking behavior: trying to bend the law or regulation to one's own purpose. And the ugly is the revolving door, and those people who move between business and government in capacities that don't strike one as meeting the level of expertise."

Hubbard explained that he does not advocate keeping business and government apart; business leaders can be very valuable in administrations and professionals with government experience make significant contributions to business. Yet not all crossovers and partnerships are successful. Lewis Kaden, vice chairman of Citigroup, agreed. "In any given administration, business and government have a complicated relationship, and there's a responsibility on both sides to do better," he said. "To me, at least in the recent period, there is more responsibility on the business side to do a better job." While companies are often quite skilled at expressing their points of view on narrow issues, many business leaders underestimate the importance of building broader and stronger relationships with government over the long term. "The fundamental objective of business should be building constructive relationships in which you have credibility," Kaden said.

Gillian Tett, US managing editor of the *Financial Times*, posed a question to Lew Kaden, vice chairman of Citigroup.

Conference guests spoke during a break.

The development of the Dodd-Frank Act demonstrated the importance of these relationships, Kaden said. During the bill's evolution, financial executives met with Congressional committee members, Treasury Department officials, regulatory agencies, and the White House. Significantly, these talks were part of a broader discussion about the financial crisis and the systemic problems that needed to be addressed. One reason these meetings were successful is that they were conducted in private, Kaden said. "We had an almost religious devotion to remaining private and that continues to this day. You won't hear us being shrill or vocal or public."

However, Matthew Bishop, the US business editor and New York bureau chief of *The Economist*, argued that businesses should disclose more about their political activities, particularly about how they use their money to influence government policy. He discussed how the political climate and the US legal system have moved in a pro-business direction to a degree that has proved worrisome; for example, over the past few decades, there has been a significant increase in Supreme Court decisions that favor business. Meanwhile, Bishop said, businesses remain reluctant to disclose more information about their political spending:

> "You can imagine a better world in which corporations use their money to actually benefit the economy. In this world, in which more than 50 percent of the money invested in the stock market is by ordinary American through their pension funds, corporations ought to be transparent to their shareholders about whether they're using their money for political purposes. That way, shareholders can reach their own decisions about whether their money is being wisely spent. There is a whole movement of activist shareholders who are seeking more transparency about political donations. And that is being fiercely resisted. While business has that mentality, it is hard to see that they are wisely pursuing their role in politics, more so than ever after Citizens United."

Hubbard disagreed. "I think there's a view that Citizens United unleashes a huge amount of money toward individual politicians, and that's not the case," he said. In fact, corporations are not permitted to donate directly to candidates or to party committees. "There are other, more serious routes through which business is influencing politics. But it's not by writing checks to politicians."

John Podesta, chair and counselor of the Center for American Progress and the Center for American Progress Action Fund, noted that despite the limitations on direct business contributions to candidates, the amount of corporate money going *indirectly* into politics has become extreme:

> "Independent groups have already spent five times as much on advertising at this point in the election as in the 2008 campaign—and we're just in the Republican primary. More than half of the $60 million collected by the super PACs comes from 24 wealthy Americans, some highly associated with particular industries or businesses. I think that's led to the attitudes that Peter Stringham discussed, and to the public's general sense that the game is rigged, that they can't participate, that their role as citizens has been diminished."

This surge in political spending by corporations comes in the immediate wake of the financial crisis, which itself left many Americans of both parties with a powerful sense that the country's system of financial regulations has been eroded. "To restore trust will take some real statesmanship on behalf of the business community," Podesta said. "Business leaders need to change they way they interact with the political system moving forward and with the American public in general."

On the question of lobbying and the dramatic rise in the number of lobbyists, several participants argued that lobbyists are the result of a flawed system, rather than a cause. "As with lawyers, there's a view that we have too many," Hubbard said. "But businesses invest when they see a return, so it must be that the self-interested pressure of lobbyists is rewarded. So I would ask, what processes could we put in place that would drain that?" Bishop agreed, noting that many of these lobbyists might simply cancel each other out. "If we had more transparency about them, we'd have a better sense of whether they were creating value for money," he said.

Kaden, however, argued that lobbyists play an important, if supporting role, in a firm's outreach efforts. When he joined


Matthew Bishop, US business editor and New York bureau chief of *The Economist*, spoke during the afternoon session.


John Podesta, chair and counselor of the Center for American Progress and Center for American Progress Action Fund, discussed the interconnectedness of business and politics.

Citigroup in 2005, the firm employed a full-time public affairs representative in only a few countries. "Companies need to look around the corner and think of the way public policy affects their plans and ambitions, and they need to have really smart people who understand public policy," he said. And the fact remains that for many companies, lobbying expands access:

> "One of the dirty little secrets is that lobbying is actually pretty cheap, when you compare it to lawyers or investment bankers. If you're a big company with a big interest in certain issues, there's an incentive to keep adding inexpensive consultants to make sure you've covered all your bases. It's not the prettiest part of our system, but on the other hand, I don't think that it's fundamentally one of the biggest problems."

Podesta agreed that lobbying can be a profit center in some industries, notably in oil and gas. His think tank estimates that the top five consolidated oil and gas companies saw a 3,000 percent return on investment on their political spending. Yet the rise in lobbying is a reflection of the economy's current complexity, he argued: "The globalization of the economy and the role of the federal government in shaping policies have become critical to the economy's functioning." It is therefore only natural that firms, through their lobbyists, will gravitate to the political sphere and try to influence policy decisions.

A member of the audience brought up the issue of corporate social responsibility. Rather than lobbying, should businesses focus on CSR efforts as a more constructive way to make a political impact? To some degree, CSR is an outmoded concept, Podesta said. "I think Peter's research shows that global, leading-edge companies are moving toward a commitment to sustainability. Today, a company's actions, good or bad, are more susceptible to public scrutiny, and the best in breed will be rewarded."

Hubbard took a nuanced view of the value of business leaders in the political realm: businesspeople are valuable not simply because of their experience, as many argue, but rather because the very complexity of the economy, and of the technical detail in certain financial regulations, makes their expertise essential. Second, good business leader are skilled at integration. "They are able to perceive fairly complicated patterns around the world, and put them together," he said. "Politicians, often less so. Putting businesspeople in that mix can provide perspective."

In the past, business leaders played an important role on the political stage, Hubbard said in the conclusion to the conference. "This is not saying that business leaders need to step up to solve social problems, but that social problems ought to be part of our common fabric," he said. "So how do we create more of these great business leaders? I do think that universities—all great universities—play a crucial role by getting people from different realms to work together. Perhaps the next big change will come from that discussion, such as through events that we are hosting today through the Bernstein Center."

And perhaps that discussion will involve a retreat from extremes and a shift back to the center, as the Brookings Institution's Alice Rivlin suggested. There is always the hope of a middle ground, that in a democracy open to new ideas, we can find ways that government and business can work together to solve society's problems.

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