

"Political Connections and Market Structure"

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Abstract

This paper empirically investigates how political connections affect market structure and quantifies the welfare cost of political influence. We focus on a specific industry, grocery retail in Italy, where the largest firm is a network of consumer cooperatives that has historical links to political parties. We estimate a game-theoretic model that accounts for the interdependence among firms' entry decisions and for the effect of political connections. The informational environment is affected by the presence of political connections, and the connected player might be better informed than its competitors. To take this into account, we adopt a new method to estimate the entry game under weak assumptions on the informational environment. We find a positive effect of political connections on cooperatives' profits, and a negative effect on some competitors. In a counterfactual, we examine the effect of removing political connections and find that consumers suffer substantially in markets where political connections act mainly as barriers to entry, but can also gain where links with local politicians help the connected firm to overcome the burden of entry regulation.