



Did Congress Cash In on Insider Stock Trading?

By Michael Edesess

December 13, 2011

Are members of Congress profiting from insider information on companies their legislation affects, or is something more complicated – and less nefarious – going on?

Those who watched the November 13 [segment](#) on *60 Minutes* that accused members of Congress of insider trading are outraged at these public servants' behavior. But that outrage should be aimed at *60 Minutes* itself, along with Peter Schweizer, whose new book, [Throw Them All Out](#), provided the misleading data that was the basis for the broadcast.

Schweizer's book, which purports to document how congressmen and women benefited financially from legal but unethical insider trading, has received a lot of attention. In addition to the *60 Minutes* piece, it was the focus of a [Wall Street Journal opinion piece](#) by former vice-presidential candidate and Alaska governor Sarah Palin, to whom Schweizer is an advisor.

If you read Schweizer's book, however, I urge you, for a dose of mundane reality that is not so polemical, to read also an important [paper](#) co-authored by Yale University's Andrew Eggers and MIT's Jens Hainmueller. Better yet, just skip over the first seven chapters of Schweizer's book and go directly to chapters 8 and 9. There you can read a good account of Congress's failure to regulate itself legally and ethically, and the crony-capitalist culture that results from it. But the first seven chapters of the book are fatally flawed, for reasons I am about to explain.

Congress and the stock market

I first learned about the *60 Minutes* segment in a November 14 [article](#) in *The New York Times*. The *Times* article doesn't mention Schweizer's book, but it does cite the same studies that Schweizer's book relies on – two papers authored by Alan J. Ziobrowski of Georgia State University and three others, one published in 2004 and the other in 2011. The first paper says that U.S. Senators' stock investments beat the market by about 10% a year; the second says that members of the U.S. House of Representatives beat the market by about 6% a year.

When I read the *Times* article, I thought, eureka! – at last an example of someone who actually can beat the market. What better way to do it than to *make* the market go up or down – for example by sneaking an advantage for a particular company into an earmark – and buying stock in the company at the same time before the public knows about the change. What an outrage!



Schweizer's book states this concisely. Speaking of what he calls the "Permanent Political Class," he says:

They obtain access to initial public offerings on the stock market that can often be lucrative. They make their investment decisions and trade stock based on what is happening behind closed doors in Washington. This might entail buying or selling stock based on what they know to be going on, or they might "prime the pump," trading stocks based on legislation they have introduced. Politicians are often extraordinarily good investors – too good to be true.

What is incredible – Schweizer explains this very well in chapters 8 and 9 – is that none of this is illegal. Virtually every other public and private citizen has a plethora of restrictions imposed on his or her legal ability to trade securities, but for Congress there is no restraint except a congressional ethics rule that members can't use their official positions for personal gain. This restraint is too weak and vague to prevent members of Congress from cashing in on their access to the levers of power through their stock portfolios.

But do they...

The trouble is, they *don't* cash in by means of their stock portfolios.

Schweizer devotes chapter upon chapter to claims of outrageous behavior and "evidence" of how richly this behavior has benefited members of Congress. The evidence Schweizer cites, however – though there may be a lot of it, and it may indeed sound damning – is mostly worthless.

The evidence that Congressmen and women benefit financially from their positions has vanished, or was possibly never sufficient to prove anything in the first place.

Let's begin with the studies. Both Schweizer's book and the *New York Times* article I read cite the Ziobrowski papers of 2004 and 2011. Though these papers do find excess performance by members of Congress as described above, the impact of these findings gets weaker when you look into the details.

Ziobrowski et al. had a hard time obtaining the data to do their studies. Professor Ziobrowski described the difficulty of the task in his [testimony to Congress](#) in 2009. The senators and members of Congress report their trades through forms called Financial Disclosure Reports, which they are required to submit annually. These reports contain inconsistencies in reporting that Ziobrowski et al. had to resolve, sometimes arbitrarily. Moreover, they are only the word of the submitters, unverified by anything more than each congressperson's personal affirmation.

The 2004 Ziobrowski study for the Senate covers senators' trades for only the years 1993-1998. Almost half of all the trades examined by the study were executed by only four



senators – John Danforth, Claiborne Pell, John Warner, and Barbara Boxer – two of whom left office before the year 2000. None of these senators is mentioned by Schweizer in his specific indictments, except for two initial public offerings in which Senator Boxer participated. The Ziobrowski study doesn't cover IPOs.

The Ziobrowski study found no significant excess returns when the stocks that were traded were equally weighted in the hypothetical buy and sell portfolios, only when they were value-weighted. This suggests that the findings could result from a small number of large trades. In fact, Ziobrowski et al. use several different ways to compute alphas, only a few of which yield statistically significant results. The alpha they cite in their abstract of 85 basis points a month is the largest they calculated – though admittedly it may be the one most appropriate to cite.

But one curious finding in the Ziobrowski study stands out. "Senators with the least seniority (in their first Senatorial term) earn statistically higher returns than those senators with the longest seniority (over 16 years in the Senate)."

This hardly justifies Schweizer's charge that a "Permanent Political Class" is cashing in by trading stocks on insider knowledge. Junior congressmen and women are notoriously powerless by comparison with those who have been in office much longer and hold senior positions. Why would junior senators be better positioned to cash in than their longer-serving colleagues?

The Eggers-Hainmueller study

Furthermore, as the [Eggers-Hainmueller study](#) points out, the Ziobrowski papers don't replicate actual portfolios of members of Congress, only the portfolios of the stocks that members of Congress purchased, and the stocks that members of Congress sold. This methodology, while it may reveal suggestive information, falls short of tracking the portfolios that the members of Congress actually held.

The Eggers-Hainmueller study uses much more recent and comprehensive data – the stock portfolios held by members of Congress between 2004 and 2008. This is noteworthy because some of the most damning of Schweizer's indictments are aimed against members of Congress who supposedly cashed in on foreknowledge of the 2007-2008 financial crisis. Yet Eggers and Hainmueller point out that, according to the results of their study, "Performance relative to the market was if anything slightly better in 2004-2006 than in 2007-2008, suggesting that on average members of Congress did not capitalize on the unusually active role of the government in the economy during the latter period."

Overall, Eggers and Hainmueller find that far from outperforming the market, members of Congress underperformed it during the period under study by 2-3% annually. The authors do find that "Members invested disproportionately in local companies and campaign contributors, and these 'political' investments outperformed the rest of their portfolios (local



investments beat the market by 4% annually)." But they also find "there is no evidence that the local trades were better timed. ... This suggests that the local premium does not emerge from members' short-term trading savvy (i.e. timing) but rather from their general sense of which local companies to invest in." They come to what sounds like a reasonable conclusion: "Their strong performance in investing in local companies seems to emerge from extensive general knowledge of these companies rather than from time-sensitive information about firm-specific or political events. These members' constituents should perhaps be pleased that their representatives seem to understand the local economy and interact closely with local leaders."

While it certainly does not directly invalidate the Ziobrowski et al findings, the Eggers and Hainmueller paper offers more convincing conclusions. Eggers and Hainmueller's data cover 25 times as many stock transactions as the 2004 Ziobrowski study, and seven times as many as the 2011 study. They use a methodology that replicates – as best it can – the actual portfolios of members of Congress, rather than hypothetical portfolios inferred from their buys and sells. Then, for good measure, it does it all again using the same methodology as Ziobrowski et al. – the buy and sell portfolios – obtaining again the same negative results.

The Eggers and Hainmueller study is not alone in these findings – a [senior thesis](#) at Claremont McKenna College obtained similar findings for the US Senate between 2006 and 2009, using Ziobrowski et al.'s method.

Schweizer's evidence

What, then, of the pages and pages of damning anecdotal evidence that Schweizer has compiled – with the help of student research assistants – to fill the bulk of Chapters 1-7?

Almost all of it is meaningless.

First of all, Schweizer can readily be seen to be cherry-picking his information, by anyone who has plumbed it for themselves. For example, in the Introduction, Schweizer cites the 2004 Ziobrowski paper's finding that the average senator beat the market (in 1993-1998) by 12%, which is already an exaggeration of their actual result. He then cites the Eggers-Hainmueller paper, but only to mention that it "found that while many individual legislators do not beat the market, they do extremely well with stock in companies with which they are 'politically connected.' They beat the market by almost 5% a year." This is grossly misrepresentative of Eggers' and Hainmueller's findings.

The specific anecdotal evidence Schweizer cites, though it sounds strong at first, is risible when you crunch the numbers. For example, Schweizer implies that Congressman Tom Lantos of California cashed in on his connection to Boeing, the aircraft company. Schweizer says, "When [Lantos] first arrived in Congress, Boeing stock was trading at \$5 a



share. By the time he died in 2008, it was \$85 a share. It's hard not to come to the conclusion that Lantos had something to do with Boeing's success."

But if you track back you find out that if Lantos had invested in the S&P 500 for that period his \$5 would have grown to \$100 instead of \$85 – a strange way to cash in on his supposed special insider deal with Boeing.

Elsewhere, Schweizer charges House Speaker Nancy Pelosi and her husband with profiting from a Visa IPO: "The Speaker of the House and her husband just happened to get those IPO shares barely two weeks after a threatening piece of legislation for Visa was introduced in the House of Representatives... Having squelched legislative action on interchange fees for more than two years, Speaker Pelosi and her husband saw their Visa stock climb in value. The IPO shares they had purchased soared by 203% from where they began, while the stock market as a whole was down 15% during the same period."

[Readily available information](#), however, shows that Visa stock never increased by more than 79% from its starting point on March 19, 2008.

Most of the other anecdotes are about some member of Congress or other buying a stock and then having it "surge" or "soar" later, supposedly after the investor used inside information to buy exactly the right stock at the right time. For example: "When the Kerrys first began buying shares, the stock was trading at around \$50. After health care reform passed, it surged to \$62."

It does not say when exactly this stock "surged" to \$62 – was it at that level when the Kerrys sold it, or was that just the high it reached after health care reform passed? If the latter, somebody should tell Schweizer – and his students – that individual stocks fluctuate up and down wildly all the time; it's the rare stock that doesn't "surge" upward or downward by as much as 20%, 30%, or more from some moment in its history to some other moment.

Unfortunately, Schweizer's anecdotes never say whether these members of Congress reaped their supposedly ill-gotten reward by selling the stock at the moment it finished "soaring" to the price quoted by Schweizer. Perhaps these members of Congress know when to buy, but do they know when to sell? Even the Ziobrowski paper finds evidence that they do not.

None of Schweizer's tirelessly reported anecdotes actually proves anything at all, not even that the member of Congress in question made out like a bandit on the particular deal. You have to have a mind-set to believe that the member of Congress *must be* cashing in to swallow these bits of evidence as willingly as Schweizer wants.

Unfortunately, for Congress and for the nation, most Americans now have that very mind-set. That fact alone means that Congress must pass the STOCK Act (Stop Trading on



Congressional Knowledge) or legislation like it. After all, it bans conduct that evidence suggests congressmen and women may not even pursue – at least not successfully – in the first place.

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