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Title:

*" Connecting to Power: Political Connections, Innovation, and Firm Dynamics. "*

*Abstract:*

*Do political connections affect firm and industry dynamics? We study the Italian firms and their workers to answer this question. Our analysis uses a brand-new data spanning the period from 1993 to 2014 where we merge: (i) firm-level balance sheet data, (ii) universe of social security data on workers, (iii) patent data from the European Patent Office, (iv) registry of local politicians, and (v) detailed data on local elections in Italy. We find that firm-level political connections are widespread, especially among large firms, and that the industries with more politically connected firms feature worse firm dynamics. Market leaders are much more likely to hire a politician and less likely to innovate, compared to their competitors. In addition, connections relate to higher survival and growth in employment and sales but not in productivity. We build a firm dynamics model where we allow firms to invest in innovation and/or rent-seeking to advance their productivity and to overcome regulatory or bureaucratic burden. The model highlights an interaction between static gains and dynamic losses from rent-seeking for aggregate productivity.*