Politicizing Consumer Credit: Comments

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Bank Lending in US Mortgage Market

Percentage of Loans by Ethnicity

2007 vs 2014

- White: 65% in 2007, 70% in 2014
- Other: 8% in 2007, 5% in 2014
- Hispanic: 11% in 2007, 9% in 2014
- Black: 8% in 2007, 5% in 2014

Source: Federal Reserve Bulletin, 2014
US Senators move into positions of power…
- banks reduce the supply of credit in their states
- effect mainly on racial minorities; risky sub-prime borrowers
- stronger effect on passive regions; stronger for politically connected banks
- banks get political protection

Big political/policy ramifications
- Redlining is not old-timey
- Banks continue to discriminate against poor and/or minority borrowers
Redlining [Baltimore, MD 1937]

Today: 19 year difference in life expectancy

North Korea does better!
Contributions

- Not shock: Exogeneity of political shock plausible since Senate Committee are decided by seniority (but not new)
- New: Distinction between political power vs. government legislation
  - Unclear to me; Should be strengthened
- Key contribution is in the empirical findings
- Speaks to multiple literatures
  - What affects bank loan supply (Puri et al 2011; Jimenez et al, 2012)
  - Racial discrimination in lending (Tootell, 1996; Charles & Hurst, 2002)
  - Lobbying by banks / mortgage lenders
Lobbying Literature

  - Banks lobby on Dodd-Frank provisions (e.g., auto-loans excluded from CFPB; Volcker rule watered down)

- Lobbying or political connections affects firm-specific outcomes (Khwaja and Mian, 2005; Faccio, 2006)

- Lobbying or political connections affects firm-specific decisions (Igan, Mishra, Tressel, 2011; this paper)

- How do politically connected lenders behave?
  - Mortgages have higher loan-income ratio (riskier)
  - Faster growth in mortgage loan portfolios
  - Securitized loans originated at faster rate
    → Lobbying associated with more risky activities
Lobbying by Banks: A Puzzle

- Banks lobbied (at least prior to crisis) for relaxation in lending laws [anti-predatory laws relaxed in 2004]; Riskier lending in data by firms more active in lobbying

- Need to reconcile with results in the paper: Lend to less risky borrowers; focus on credit worthy borrowers; less to sub-prime borrowers (Figures 3 and 4)

- One way
  - Campaign finance contributions via PACs (in paper)
  - Lobbying legislative branches of government (accounts for bulk of politically-targeted expenditures)
  - Data used in Igan et al paper
Ideally...

- **A Model**
  - Game between Politicians, Constituents (borrowers) & Banks that lobby: Protection for Sale in Trade Literature (Grossman & Helpman, AER) 1994

- Absent model...details on political incentives & bank incentives
  - I see the results; I struggle with mechanisms/connections
  - As a bank, why should I reduce lending if the Senator in my state becomes part of a powerful committee?

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Panel A

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<th>(1)</th>
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<tr>
<td><strong>Sample: supply ratio</strong></td>
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<tr>
<td><strong>Powerful Politician</strong></td>
<td>-0.0142*</td>
<td>-0.0143**</td>
<td>-0.0176**</td>
<td>-0.0176**</td>
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<td></td>
<td>(0.0073)</td>
<td>(0.0071)</td>
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<td><strong>Powerful Politician × Majority Minority</strong></td>
<td>-0.0190*</td>
<td>-0.0145</td>
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<td>(0.0099)</td>
<td>(0.011)</td>
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<td><strong>Majority Minority</strong></td>
<td>-</td>
<td>-</td>
<td>-0.0149***</td>
<td>-0.0129**</td>
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Lending to Riskier Borrowers Makes More Sense Combined with Important Committees

- **Important/Relevant Committees**
- As a bank why should I reduce lending to minority, poorer, riskier borrowers if the Senator in my state becomes part of an important committee?
  - Intuitive; Still looking for a mechanism
Institutional Details

- Institutional details will help
  - Some committees are powerful (6 of them) in terms of affecting banking regulations
    - Focus on these
  - What do banks get when banks buy political protection
    - Even anecdotal evidence would be good!

- More events
  - House Committees vs. Senate Committees (Not just Dodd but Frank too)
  - Seniority event can happen if Senator not up for elections but control shifts (also plausibly exogenous; should not be dropped)
Simplify & Focus…

- Dizzying array of specifications
  - Two dependent variables (one of them disaggregated as well)
  - Powerful politicians; Important politicians
  - Majority Minority vs. High-Low Income
  - All Consumers vs. Risky Consumers
  - Politically connected constituents vs. not
  - Bank is politically connected vs. not
  - Fixed effects at individual vs. census-tract level
  - Many sub-sample restrictions

- Specification changes multiple times

- One specification to rule them all. Example…
Example: Measures of Demand and Supply

- Supply of credit (\# new accounts/ \# new applications = supply ratio)
  - \# new applications = measure of demand (Puri, Rocholl & Steffen, JFE 2011)
  - \# new accounts/credit lines = measure of supply
  - Common alternates:
    - Indicator variable = 1 if loans approved (Puri et al, JFE 2011; Jimenez et al, AER 2011)
    - Loan amount approved or \# of loans approved (Hirtle, 2008)
  - Supply/Demand as supply ratio confusing

- Presentation of empirics
  - Table 2, Panel C shows the denominator does not matter
  - But then proceeds to use supply ratio (Table 3, 7, 8…)
  - \# of new accounts in one specification Table 4, Panel B; Table 5 but specifications not comparable to baseline

- Preferred specification: measure just supply as \# new accounts
The Danger: Garden of Forking Paths

- Robust baseline specification
- My preferences
  - Diff-in-diff graph [test parallel trends with leads & lags]
  - Important politicians* Majority-minority
  - Sub-prime subsample
  - Politically connected banks; politically passive constituents
  - Break at eligibility threshold
  - Placebo tests
  - Crisis effect?
- Drop most of the rest or footnote/appendix
  - Less is more
  - Ashenfelter dip? Worry about number of clusters (50 enough)?
Overall Food for Thought

- Having your state Senator become powerful is bad news
  - Decline in lending
  - To the tired, the poor, the huddled masses
  - Rise in inequality
  - Decline in corporate R&D [Cohen, Cavol & Malloy]
  - Earmarks, transfers from Federal government?