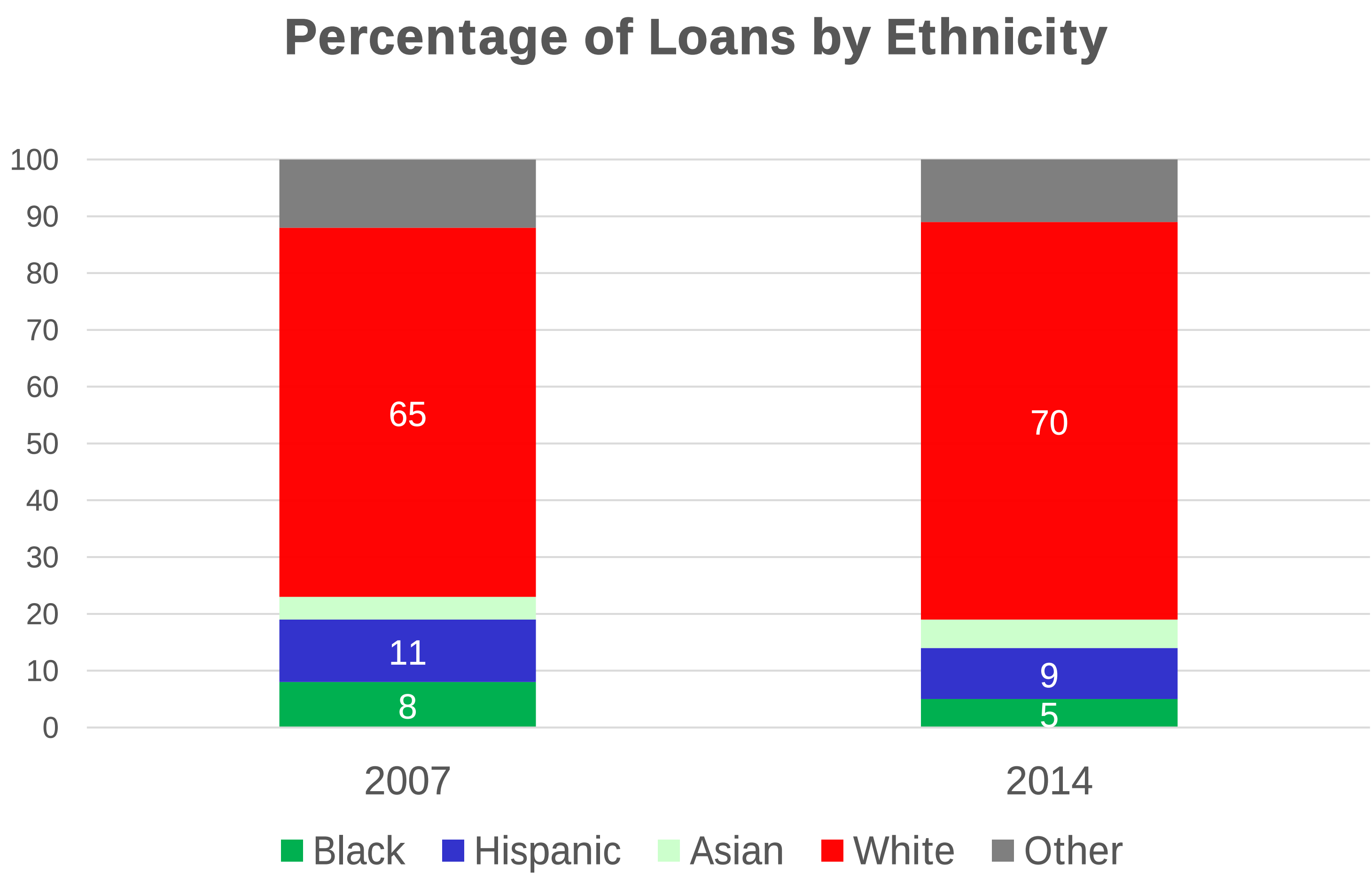
INSEAD

The Business School for the World

Politicizing Consumer Credit: Comments

Pat Akey, Rawley Heimer, Stefan Lewellen

Bank Lending in US Mortgage Market



Source: Federal Reserve Bulletin, 2014

Very Provocative & Though-Provoking Paper

- US Senators move into positions of power...

  → banks reduce the supply of credit in their states

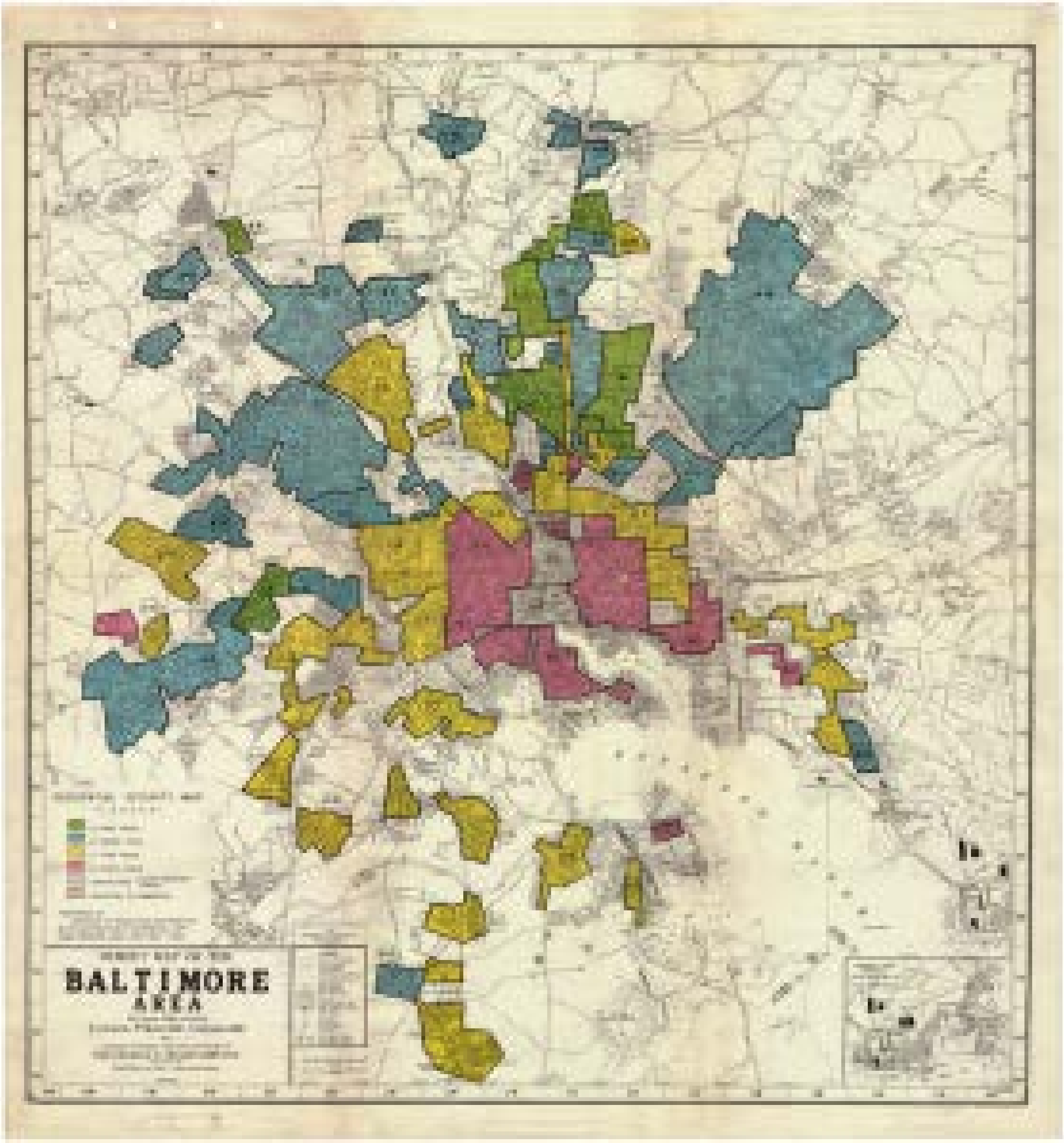
  → effect mainly on racial minorities; risky sub-prime borrowers

  → 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

- Lobbying activities lead to specific policies (Grossman and Helpman 1994, Goldberg and Maggi 1999; Kroszner and Stratmann, 1998, 1999)
  - 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?

Panel A

	dep var: supply ratio *sample*: all consumers			
	(1)	(2)	(3)	(4)
$Powerful\,Politician$	-0.0142*	-0.0143**	-0.0176**	-0.0176**
	(0.0073)	(0.0071)	(0.0069)	(0.0069)
$Powerful\,Politician \times Majority\,Minority$	-0.0190*	-0.0145	-0.0127	-0.0127
	(0.0099)	(0.011)	(0.011)	(0.011)
$Majority\,Minority$	-	-	-0.0149***	-0.0129**
	-	-	(0.0055)	(0.0054)

Lending to Riskier Borrowers Makes More Sense Combined with Important Committees

dep var:	supply ratio			
sample:	consumer riskscore < 640,			
	(1)	(2)	(3)	(4)
Important Politician	-0.00979	-0.0101	-0.00284	-0.00278
	(0.015)	(0.015)	(0.016)	(0.016)
Important Politician $\times$ *Majority Minority*	-0.0241***	-0.0237***	-0.0302***	-0.0302***
	(0.0060)	(0.0062)	(0.010)	(0.010)
Majority Minority			-0.00406	-0.00221
			(0.0061)	(0.0063)

- 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
  - Potentially illegal? Violates Equal Credit Opportunity Act (1974) & Community Reinvestment Act (1977)

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?