Politicizing Consumer Credit

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Disclaimer

These are our views and not necessarily those of the Federal Reserve Bank of Cleveland or the Board of Governors.

Introduction

- Political power can take many forms
  - **Hard Power:** earmarks, contracts, legislation, votes
  - **Soft Power:** implicit protection from things like regulation
  - **Many papers on how politicians use hard power to benefit firms; little evidence on how they use soft power**
    - Very challenging to test — unobservable + need the right benchmark

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  - **Many papers on how politicians use hard power to benefit firms; little evidence on how they use soft power**
    - Very challenging to test — unobservable + need the right benchmark
- Can powerful politicians provide connected firms with political cover to evade existing regulations?
- Our setting: the market for consumer credit in the U.S.
  - A market where substantial information asymmetries and discrimination have historically been present
    - New borrowers are hard to screen; redlining at one time prevented a large number of consumers from accessing credit/housing markets
  - The government imposed lending regulations in the 1970s to try to address these frictions $\Rightarrow$ the benchmark
  - Relatively easy to observe who "wins" and who "loses"

Politicians and Credit

- Politicians routinely talk about expanding access to finance
  - George W. Bush's "Ownership Society"
  - Kirk-Manchin – The Credit Access and Inclusion Act of 2015
    - Bill introduced to make it easier to to get a credit score — died in committee

"1.4 million men and women in Illinois are unable to build a credit score, making it very difficult to get a loan, mortgage or credit cards."
—Mark Kirk (R-IL)

What we know

- Little evidence exists to show how politicians actually impact access to credit
  - A few studies look at credit provision and electoral incentives (e.g. Anoniades and Calomires (2016), Carvalho (2014), Chavaz and Rose (2017))
    - During elections, politicians seem to boost credit
  - A few papers look at politicians' behavior before and during the crisis (e.g. Mian, Sufi and Trebbi (2010, 2014))
    - Constituent interests and political contributions from mortgage providers seemed to predict legislators actions and votes (hard power)
  - Several studies look at the impact of *specific legislation* (CARD Act — Chomsisengphet, Mahoney and Stroebel (2015), HAMP— Agarwal, Amromin, Ben-David, Chomsisengphet, Piskorski, and Seru 2016) — these *collective actions* seem to increase access to credit

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- In contrast, we are unaware of any studies that look at how changes to *political power* impact consumer credit outcomes

This paper

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- Exploit shocks to the leadership of powerful U.S. Senate Committees
  - Leadership is determined by political party, *committee* seniority
- Examine household credit in the states affected by each shock relative to other states at the same point in time
  - Confidential, micro-level data on credit histories of U.S. consumers
    - Mortgages, auto loans, student loans, personal loans, credit cards
  - Credit utilization, # new applications, # new credit inquiries

Main Findings

- Shocks to Senators' power lead to a *reduction* in credit supply for borrowers in home state (4.5–8% of the sample average).
  - Particularly for
    - Subprime borrowers
    - Historically disadvantaged borrowers (racial minorities)

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    - Historically disadvantaged borrowers (racial minorities)
- Effects vary in the cross-section in a way that is consistent with political protection
  - Effects are *stronger* for regions with more politically active banks
  - Effects are *weaker* for regions where borrowers are politically engaged and *stronger* for regions where borrowers are politically unengaged
  - Discontinuously *stronger* effects when the Community Reinvestment Act (CRA) "just binds"

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  - Discontinuously *stronger* effects when the Community Reinvestment Act (CRA) "just binds"
- Evidence suggests a tighter screening on "low-quality" borrowers
  - Borrowers that *do* receive loans
    - have higher credit scores
    - more experience with credit
    - default less often
  - Banks become more profitable

Data

- Consumer credit data: FRBNY Consumer Credit Panel
  - 5% random sample of all consumers with Social Security number and Equifax credit profile
  - Very detailed credit history, though no individual consumer data apart from age / census block
  - Sample period: 1999Q1 - 2012Q4
- Main variable we use is $Supply\,Ratio = \frac{New\,Credit}{Num.\,Inquiries}$
  - Roughly captures the propensity of an individual to receive credit
- Powerful politician data: Edwards and Stewart (2006)
  - Find all instances where a Senate Committee chair changed
  - Use Edwards and Stewart's list of "most powerful" committees
  - Sample period: 1999 - 2012
- Other data sources
  - Census block-level demographics: US Census Bureau
  - Individual contributions: Federal Election Commission
  - Bank data: Call reports and Summary of Deposits

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  1. Current chair steps down as chair and the "number two" politician is promoted
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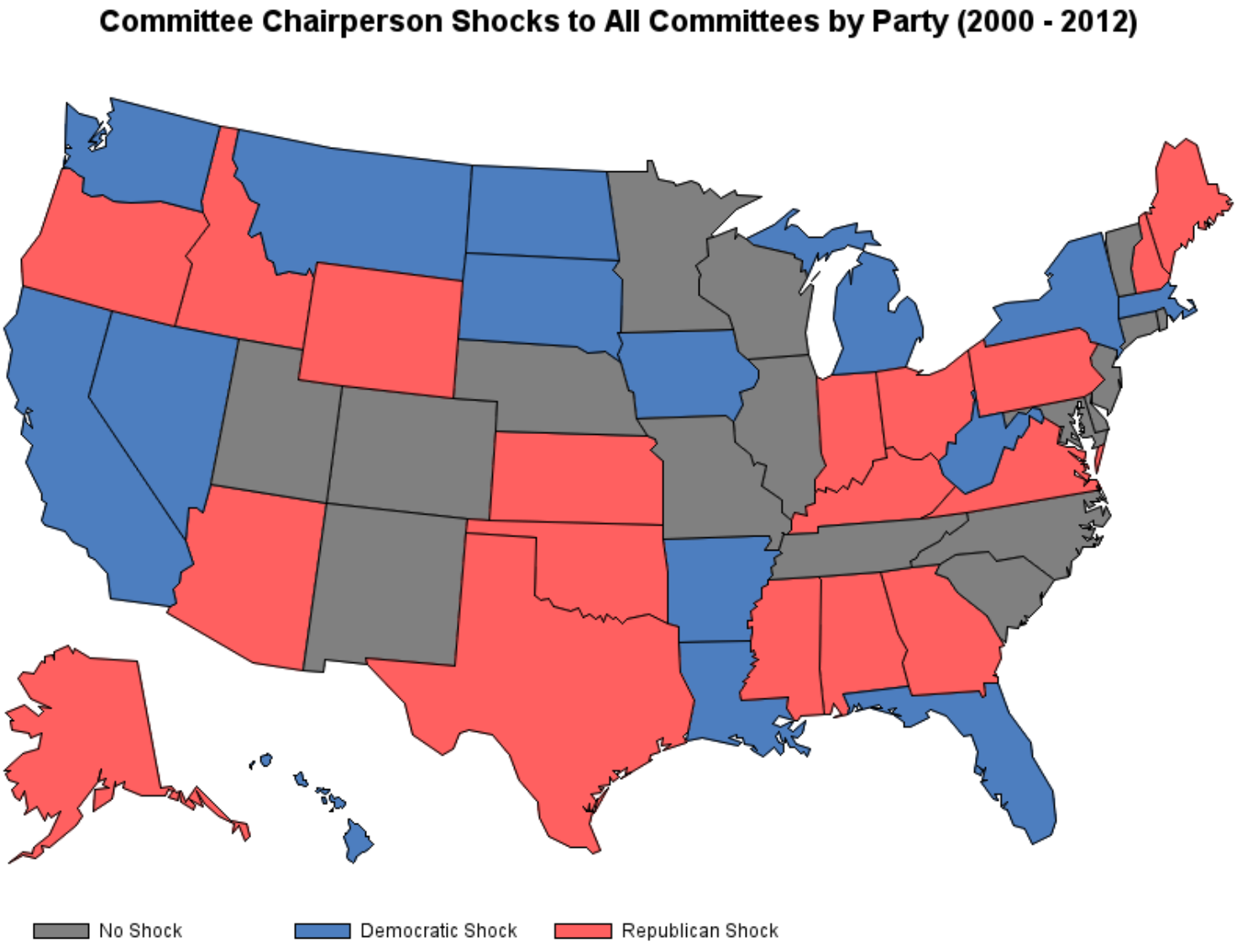
- Time between joining a committee (starting to get seniority) and becoming Chair can easily be well over 20 years
  - Example: Appropriations Committee chair switches from Daniel Inouye (D – Hawaii) to Barbara Mikulski (D – Maryland) in late 2012 after his death
    - She sat on the committee since 1987 — establishing her seniority
    - Plausibly exogenous w.r.t. the affected *states* (Hawaii, Maryland)

Shock Distribution



Senate Ascensions

- Senate Ascension unrelated to macroeconomic conditions

Panel B — Lagged Macroeconomic Variables and Political Shocks

Dependent Variable: *Powerful Politician*

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Lag Log(GDP)	-0.198						
	(0.231)						
Lag Log(Personal Income)		-0.385					
		(0.316)					
Lag Log(Employment)			-0.580				
			(0.428)				
Lag Log(Disposable Income)				-0.479			
				(0.324)			
Lag Log(Unemployment Rate					-0.0332		
					(0.0201)		
Lag Log(House Price Index						0.0571	
						(0.187)	
Lag Log(Bankruptcies)							-0.0339
							(0.0383)
Year FE	X	X	X	X	X	X	X
State FE	X	X	X	X	X	X	X
Observations	650	650	650	650	650	650	650
Within R-squared	0.00111	0.00219	0.00276	0.00326	0.00584	0.000246	0.00115

Empirical Analysis

- Baseline analysis

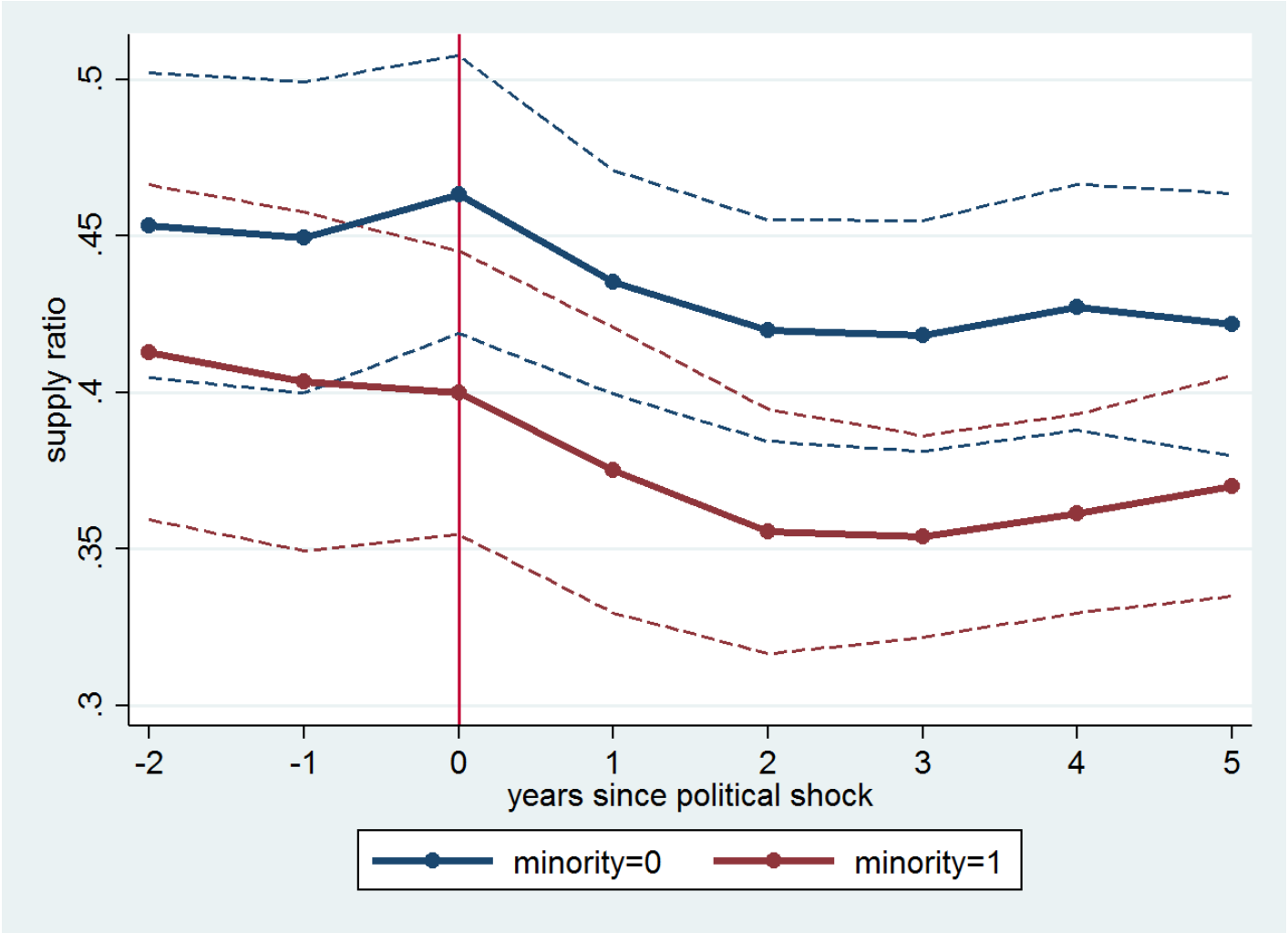
$$Credit\,Outcome_{i,g,t} = \beta_1 \times Powerful\,Politician_{g,t} + \Gamma' Controls_{i,g,t} + Time\,FE + Location\,FE + \epsilon_{i,g,t}$$

- Demographic analysis

$$Credit\,Outcome_{i,g,t} = \beta_1 \times Powerful\,Politician_{g,t} + \beta_2 \times Powerful\,Politician_{g,t} \times Demographic\,Char_g + \Gamma' Controls_{i,g,t} + Time\,FE + Location\,FE + \epsilon_{i,g,t}$$

- $Powerful\,Politician_{g,t} = 1$ for two years after the ascent to chair

Marginal Borrowers and Race Graphically



Placebo Test

Powerful Politicians and Credit Access

	dep var: supply ratio *sample*: consumer riskscore $<$ 640			
	(1)	(2)	(3)	(4)
$Powerful\ Politician$	-0.0147*	-0.0140*	-0.0191***	-0.0190***
	(0.0074)	(0.0072)	(0.0071)	(0.0071)
$Powerful\ Politician \times Majority\ Minority$	-0.0225**	-0.0208**	-0.0130*	-0.0130*
	(0.0085)	(0.0086)	(0.0075)	(0.0075)
$Majority\ Minority$	-	-	-0.00422	-0.00234
	-	-	(0.0066)	(0.0069)
$Consumer\ Riskscore/100$		0.0930***	0.0665***	0.0665***
		(0.0038)	(0.0042)	(0.0042)
$Census\ Tract\ Median\ Income\ (Z)$				0.00278
				(0.0032)
date - quarter FE	x	x	x	x
Census tract FE	x	x		
consumer FE			x	x
N	1077773	1077773	1074941	1074678
adj. R^2	0.19	0.19	0.26	0.26

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- Minorities experience particularly bad outcomes following the shock
  - Total effect on minorities is -0.0348 — 7.5% of the sample mean
- Results not coming from the denominator

Interest Groups?

- Maybe effects are different in areas that are politically engaged?
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- How to identify or measure interest groups?
  - Personal political contributions to Senators
- We rerun our analysis in ares that were above and below median political contributors to see how the effects differ

Credit outcomes and interest groups

dep var: Supply Ratio	campaign contributions in zip code: above median		below median	
	(1)	(2)	(3)	(4)
$Powerful\ Politician$	-0.0106	-0.0102	-0.0189**	-0.0180**
	(0.0096)	(0.0093)	(0.0073)	(0.0071)
$Powerful\ Politician \times Majority\ Minority$	-0.0159	-0.0156	-0.0251***	-0.0229***
	(0.014)	(0.014)	(0.0078)	(0.0081)
$Consumer\ Riskscore/100$		0.0980***		0.0869***
		(0.0040)		(0.0041)
date - quarter FE	x	x	x	x
Census tract FE	x	x	x	x
N	491,986	491,986	584,987	584,987
adj. R^2	0.20	0.20	0.19	0.20

Political Incentives

- Politically unengaged areas experience the contraction in credit
- Does this diffuse differently through politically active banks?

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- Does this diffuse differently through politically active banks?
- We examine political contributions to the shocks Senators (prior to the shock) by Political Action Committees run by the banks in our sample
- We compute fraction of bank branches in an area as affiliated with a politically active bank and repeat this analysis in above and below median areas of political bank branch penetration
  - Results similar using equal or deposit-weighted for fraction calculation

Politically Connected Banks

dep var:	supply ratio			
sample:	consumer riskscore $<$ 640,			
	Equally-weighted fraction of politically connected branches in county			
	above median		below median	
	(1)	(2)	(3)	(4)
$Powerful\ Politcian$	-0.0133	-0.0124	-0.0179*	-0.0175*
	(0.011)	(0.010)	(0.0094)	(0.0098)
$Powerful\ Politcian \times Majority\ Minority$	-0.0272***	-0.0259***	0.00181	0.00295
	(0.0094)	(0.0092)	(0.016)	(0.016)
$Consumer\ Risk\ Score$ 100		0.0891***		0.0976***
		(0.0037)		(0.0050)
date-quarter FE	X	X	X	X
Census tract FE	X	X	X	X
N	568823	568823	508950	508950
adj. R^2	0.17	0.18	0.20	0.20

Politicians and Credit

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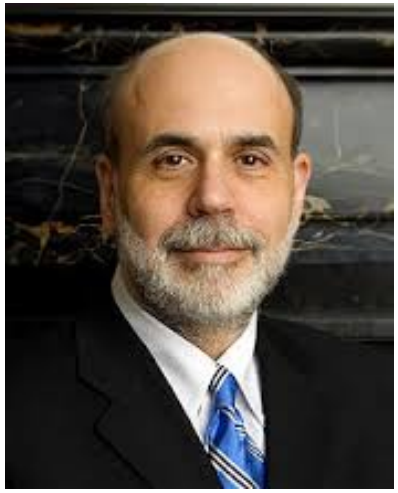
- Analysis so far has shown that marginal borrowers lose access to credit following shocks to political power
- Banks face regulatory restrictions on their lending practices
  - Community Reinvestment Act — banks must extend credit to serve the needs of the communities where they operate
    - Acts as a constraint on a bank's lending portfolio (e.g. Agarwal, Benmelech, Bergman, and Seru (2016))

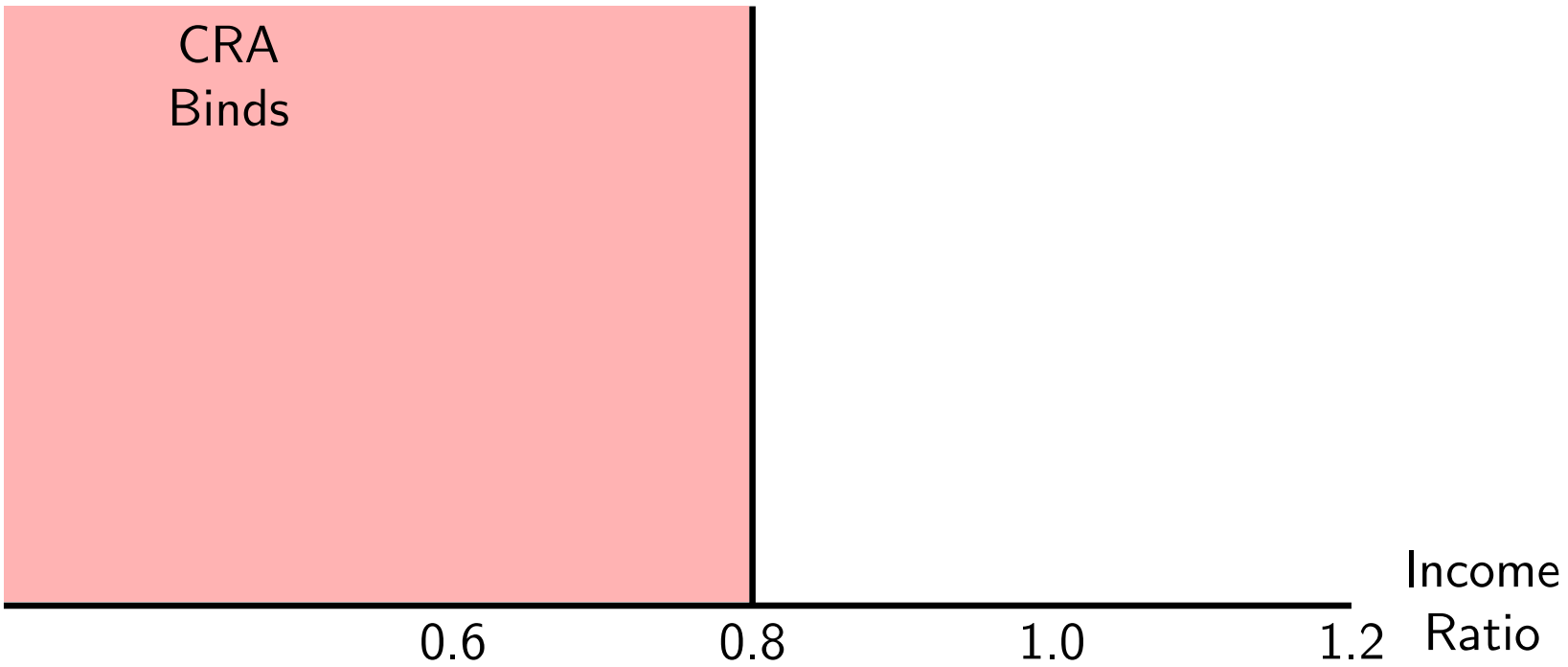


"The obligation of financial institutions to serve their communities was seen as a quid pro quo for privileges such as the protection afforded by federal deposit insurance and access to the Federal Reserve's discount window."

Channel — Less Binding Regulatory Constraints

- CRA binds in neighborhoods where the median income is 80% of the median income of its MSA
- Senate power shocks could represent a relaxation of these constraints and an increase in the ability of a bank to screen borrowers
  - Does the reduction in supply become stronger at the threshold when the CRA binds?
  - Do the characteristics of loans made change following the shocks?
  - Are default rates of new loans different?
  - Do banks become more profitable?

CRA tests graphically



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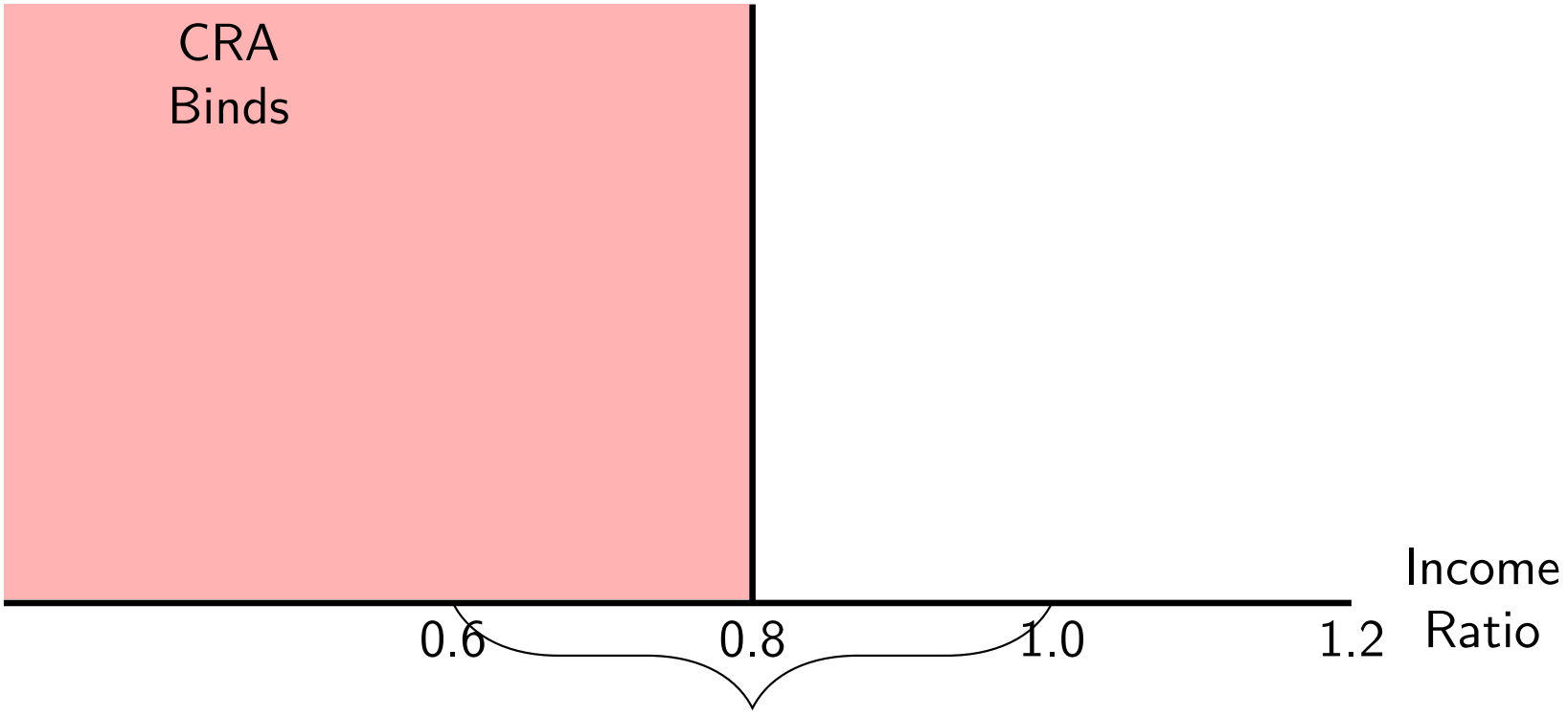

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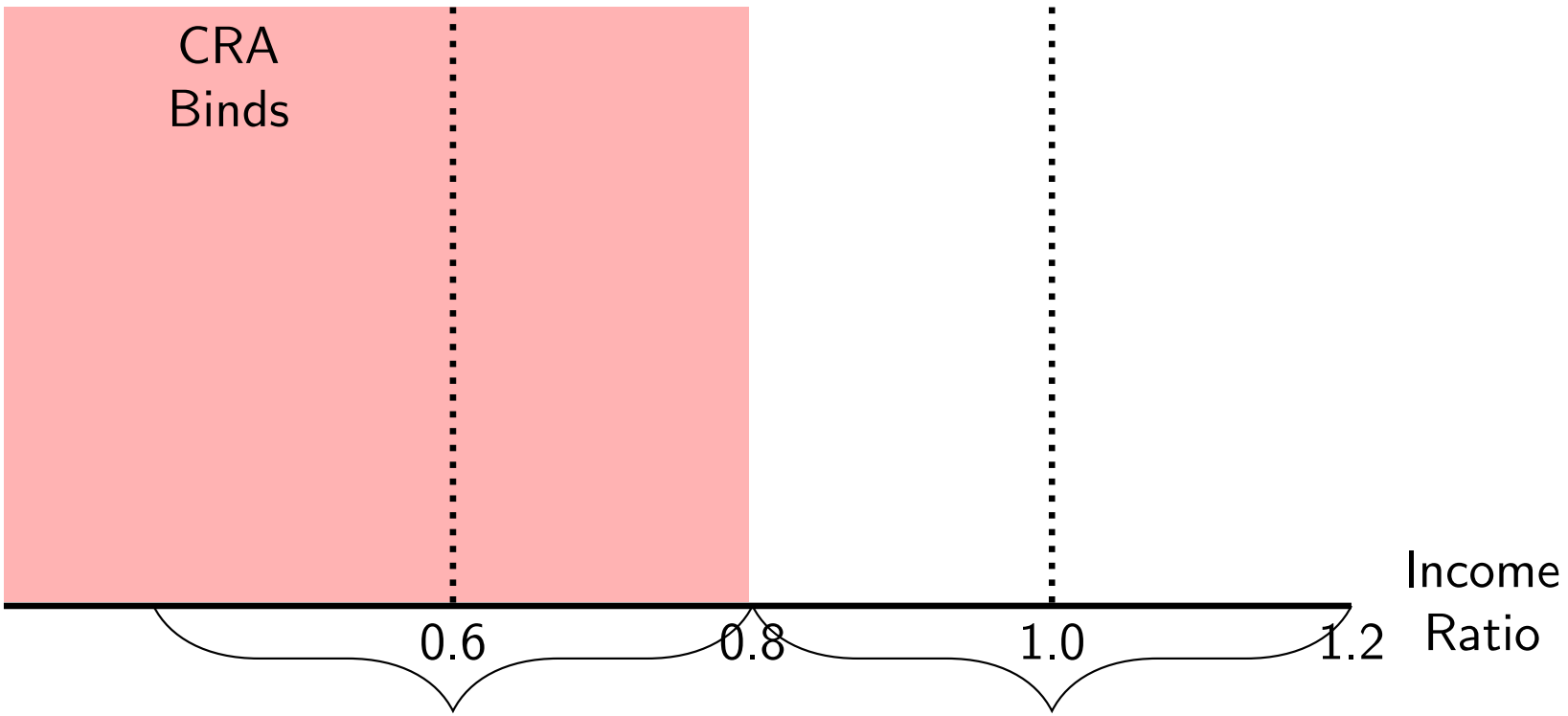
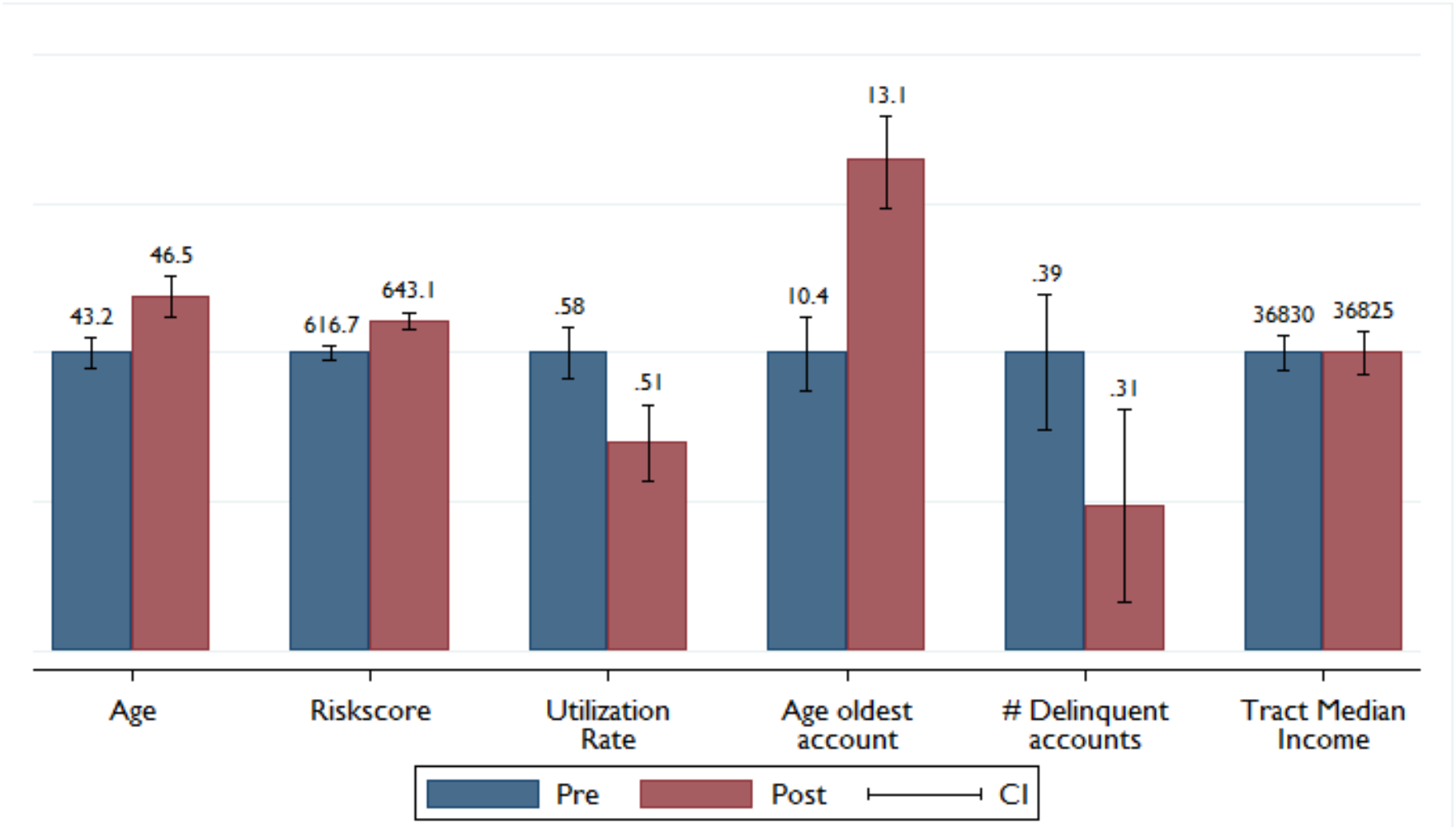


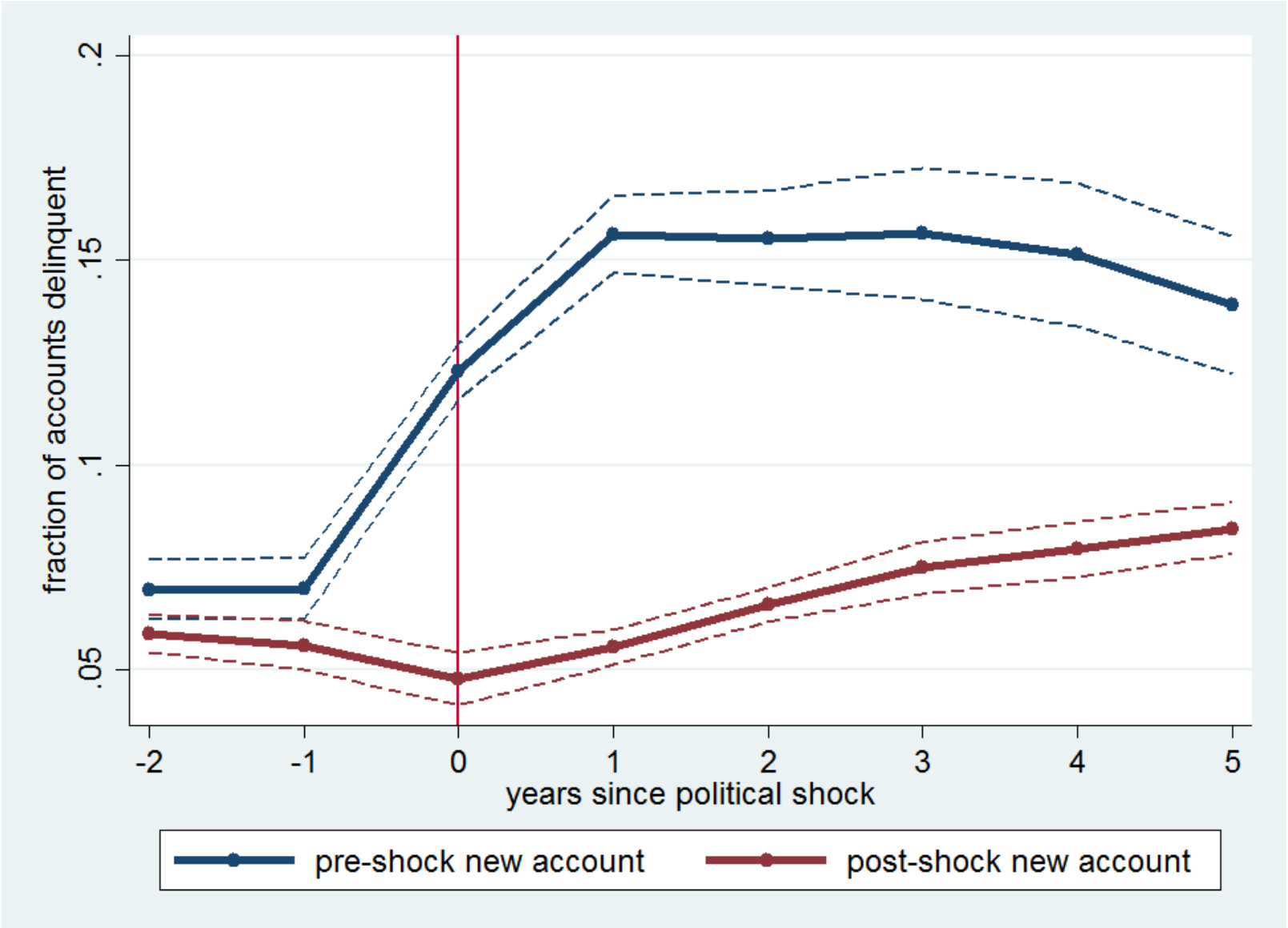
CRA tests

dep var:	supply ratio			
sample:	all consumers			
	(1)	(2)	(3)	(4)
$Powerful\ Politician$	-0.0164*	-0.0155	-0.0257	-0.0349***
	(0.0084)	(0.011)	(0.016)	(0.010)
$Powerful\ Politician \times CRA\ Eligible$	-0.0166**	-0.0184**		
	(0.0076)	(0.0087)		
$Powerful\ Politician \times CRA\ Placebo\ A$			0.0105	
			(0.014)	
$Powerful\ Politician \times CRA\ Placebo\ B$				0.00175
				(0.017)
CRA neighborhoods	All	0.6–1.0	0.8–1.2	0.4–0.8
date - quarter FE	X	X	X	X
Census tract FE	X	X	X	X
Observations	875566	376315	396031	237729
R-squared	0.18	0.17	0.17	0.18

Borrower Characteristics — Minorities



New Account Delinquency Dynamics



Bank Profitability

	All Banks		Same-State Banks	
	(1)	(2)	(3)	(4)
	ROA	ROA	ROA	ROA
$Powerful\ Politician$	0.000151**	0.000136*	0.000191**	0.000160**
	(7.06e-05)	(6.87e-05)	(9.10e-05)	(6.43e-05)
$Bank\ Size$		0.00171***		0.00292***
		(0.000143)		(0.000226)
Time FE	x	x	x	x
State FE	x	x	x	x
Bank FE	x	x	x	x
Observations	502,237	502,237	267,775	267,775
R-squared	0.547	0.565	0.588	0.625

What about other types of lending?

- Maybe investment opportunities are changing for the bank or other types of loans are becoming relatively more profitable
  - Banks are just responding to different profit maximizing conditions
- We look at bank-level lending using call report data to see if there is evidence of such a change

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	All Banks			Same-State Banks		
	(1) $\frac{Real\ Estate}{Total\ Loans}$	(2) $\frac{Commercial}{Total\ Loans}$	(3) $\frac{Consumer}{Total\ Loans}$	(4) $\frac{Real\ Estate}{Total\ Loans}$	(5) $\frac{Commercial}{Total\ Loans}$	(6) $\frac{Consumer}{Total\ Loans}$
$Powerful\ Politician$	-0.00541	-0.00258	0.00325	-0.00641*	0.00190	0.00149
	(0.00338)	(0.00453)	(0.00225)	(0.00322)	(0.00423)	(0.00184)
Time FE	x	x	x	x	x	x
State FE	x	x	x	x	x	x
Bank FE	x	x	x	x	x	x
Observations	501,585	501,585	500,787	267,193	267,193	266,395
R-squared	0.888	0.751	0.868	0.905	0.773	0.894

Conclusion

- We examine how shocks to Politicians' power impact consumer credit markets in their home state
- We find that following a Senator's ascension to chair of a committee, marginal borrowers lose access to credit markets
  - These shocks lead to a decrease of 4.5–8% of the average supply ratio
- These effects are amplified in areas that are politically unengaged as well as in areas where there is a higher concentration of politically active bank branches
- Results seem consistent with a loosening of screening constraints, potentially because banks are complying less with the CRA
  - Loans extended post shock are of higher observable quality
  - Default rates of post shock loans are lower
  - Banks become more profitable

Placebo T-Statistics