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Private Credit under Political Influence

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Discussion by Martin Götz

What is the paper about?

- Research Question:
  - Do banks that increase private credit in an area before an election experience an increase in their lending to public entities?

- Focus on local elections in France (2007, 2012, 2017) and implements several diff-in-diff analyses

- Finds that in contested elections …

  …credit to the private sector in an election year increases if the politician is powerful,

  …this increase comes from banks that traditionally lend more to the public sector, and

  …banks that increased private lending during election year experience a larger growth of loans to public entities if the powerful politician is re-elected

- Interpretation:
  - Powerful politicians reciprocate and repay banks when they are re-elected by helping them expand credit to public entities

My two cents

- Very nice paper with an important question and interesting findings

- Literature examining political (lending) cycles, interplay between government and finance, politics and finance, etc.
  - Lending to politically connected firms (Khwaja & Mian, 2005)
  - Political cycles and lending (Koetter & Popov, 2021); Englmaier & Stowasser, 2017))
  - Moral suasion and investment in government securities (Becker & Ivashina, 2018; Ongena, Popov & van Horen, 2019)
- Here: Ability of politicians to (re)direct credit

- Findings on lending to public entities shed new light on interplay between politics and finance
  - Lending to public entities
    - not regulated,
    - big,
    - gives politicians a lot of discretionary power.
  - Potential misallocation of capital

- Empirical set-up convincing and story clear

Reciprocity I

- Why should we see an increase in lending *only* for contested elections?
  - Antoniades & Calomiris (2018):
    - Loan contractions lead to voter punishment, but there is no positive effect of lending expansion.
    - Different patterns in pre-crisis election vs. later elections?
  - How costly is (re)direction of credit to public entities for the politician?
  - What is downside to bank?

- A back-of-the envelope calculation would help to gauge the magnitude of the cost/distortion.
  - Maybe also show benchmark effects (contested * election, etc.)

- Findings show that banks lend to unproductive, risky firms in election year.
  - Why unproductive, risky firms to support incumbent?
  - Shouldn‘t they target households directly or firms that produce the largest number of votes, i.e. small firms, local firms?

- How much power does a powerful politician have after a contested election?

Reciprocity II

- Using previous abnormal private credit to measure „favor“ bank convincing
  - I would like to see some summary stats on this variable, though
    - Are these involved banks?
    - Is “favor” mean zero?
    - How is it related to „involvement“ of bank/”cooperative”?
  - Not clear where identification currently comes from?
    - Specifically: what is source of variation and magnitude
    - One (large) bank that supplies abnormal credit in constituency and year and then also supplies this after election?
  - Is “favor” a proxy …
    - … for “political cycle” lenders? (Similar pattern for public credit?)
    - … for local lenders?

- Split between debt controlled by local and central government interesting and consistent
  - Coefficients much smaller, but show similar pattern; significance affected by magnitude of “Favor”?

Dynamics around the election may be interesting

- Analyses documenting pattern around elections would be helpful
  - Is credit expanding only in election year? Or also before?
  - When do involved banks increase their lending to public entities?
  - (Border effect at constituency? Control group: contiguous constituency)

- Also: whether election was contested identified ex-post
  - Possible to exploit surprise outcomes?

- Paper argues a politician needs to be (a) powerful (within party) and (b) can influence others
  - What is more relevant? Can this be analyzed?

- Is this a cooperative effect?
  - „Involved“ banks tend to be (local) cooperative banks.
    - Is there something special about them (governance structure, local focus, etc.) that drives part of the results?
    - Results robust to only examining cooperative banks?

Some minor points

- Credit = credit line (drawn + undrawn).
  - Drawdown of credit line and extension of credit line or
  - Increase in (unused) credit line?
- Paper studies quantities. What about interest rates?

- Why transform monthly loan data into quarterly?
- Why aggregate information at bank-type (involved vs. others) vs keeping it at the bank-level?

- What is short-term credit? Is distinction important?
  - Effect seems to come from short-term credit (Table 5)
    - Can you test this formally?
    - Synched with the election cycle?

- Spatial correlation and clustering of standard errors

Great paper: Read it

Thank you