

# Banking on Politics

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Conference on the Political Economy of Financial Crises

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# Motivation

Why are some countries financially underdeveloped?

- Political economy explanations (Haber and Perotti, 2008)
  - Distributive consequences (winners and losers)
    - Rajan and Zingales (2003), Pagano and Volpin (2001), Braun and Raddatz (2007, 2008), among many others
  - Laws and regulations matter
    - La Porta et al (1997), Acemoglu and Johnson (2003)
- PE requires interaction between politicians and interested parties
  - Can take many forms (lobbying, bribing, etc.)
- Documenting these interactions and their relation to outcomes is important

- One likely important interaction:
  - Politicians and incumbent banks
- One specific form:
  - Politicians (regulators) working in banks (revolving door)
    - Extent to which former cabinet level politicians and financial regulators become bank board members
  - Specific form of “revolving door”, but one that has advantages
    - Open, because it may be also an efficient outcome
    - Compared to executive positions (CEO) more likely to be used for quid pro quos
- Whether this is an efficient outcome or manifestation of private interest is an empirical question

# This paper

## Four goals

- 1 Document the frequency of this form of connection in a broad set of countries
- 2 Where is it more prevalent?
- 3 Is it beneficial for incumbents?
- 4 What do we learn about potential explanations?

- 1 Presence of cabinet level politicians and regulators in bank boards is relatively rare
  - Depends on the metric
    - 0.3% of bankers were politicians in previous 10 years
    - But 10% of banks have a politician in their board...
- 2 Cross sectional variation is robustly correlated with important bank and country characteristics
  - Connected banks are larger and more profitable without taking more risk
  - Countries where connections are more prevalent have:
    - Governance indicators (-)
    - Regulatory quality (-) and bias in favor of incumbents (+)
    - Financial development (-)
- 3 Combination of reduced form findings is hard to reconcile with a benign view

# Measuring the connection between bankers and politicians

- Politicians

- Economist Intelligence Unit Country Reports 1996-2005: 72,769 names of cabinet members and central bank governors (10,000 unique)
- How Countries Supervise their Banks, Insurers, and Securities Markets 2000-04: 593 names of financial sector supervisors
- Virtually universal coverage for cabinet members and financial sector regulators in about 150 countries for 1996-2000.

- Bankers

- Bankscope: 109,645 bank board members around 2005 (62,000 unique)

- Name Matching (Record-Linkage Algorithm)

- Standardization of the strings containing the names
- Removal of duplicates within each dataset
- Matching of unique individual names across datasets
- All the pairs with similarity above 0.8 were visually checked

# Measuring the connection between politicians and bankers

## Sample outcome

Country	Banks with director data in Bankscope (2005) (1)	Total number of directors (2)	Number of politicians (1996- 2004) (3)	Matches (politician- bankers) (4)	(# Banks in bankscope)/ (# Commercial (5)	(Assets in banks with director data)/ (All (6)
Switzerland	194	2917	21	1	1.070461	0.91
Japan	166	2725	122	1	3.606838	0.73
Italy	315	4968	90	5	0.9433735	0.93
United States	546	9145	86	7	0.1663158	0.6
Germany	532	9723	60	5	0.7248614	0.75
Spain	86	1836	76	1	0.5964912	0.93
Argentina	81	358	83	1	1.162791	0.56
France	233	3484	76	1	1.108108	0.69
United Kingdom	275	2814	63	3	0.9723618	0.97
Australia	45	408	56	1	1.25	0.96
Belarus	11	115	81	5	0.6666667	0.6
Cameroon	2	27	78	1	.	0.26
Malta	4	41	40	2	0.5333334	0.86
Rwanda	4	42	71	2	0.8333333	0.29
Angola	3	25	57	2	.	0.26
Burundi	6	73	101	6	0.7142857	0.95
Madagascar	3	32	94	2	1.1666667	0.88
Gabon	3	42	51	4	.	0.63
Georgia	1	25	87	2	.	0.8
Myanmar	1	16	58	3	.	.
Total	28.16	416.68	72.24	1.42	1.05	0.72

# Measuring the connection between politicians and bankers

## Some issues

- Average number of matches is unimpressive:
  - 1.4 average matches per country (0.34% of bankers)
    - In other metrics is not that small
  - This is only one way in which bankers and politicians can be connected
    - Narrow view of “politicians”
  - We see this as a proxy (“tip of the iceberg”)
- In 40% of countries there is no match
  - Most of analysis drops these countries
    - Data quality (only 20% meets IMF data dissemination standards)
    - Small # of banks in bankscope among zeroes (1/3 has less than 3 banks)
    - Information content in zeroes is low
    - Nevertheless...

# Measuring the connection between politicians and bankers

Measuring connections at aggregate level

$$FRACBANKS = \frac{\#CONNECTED BANKS}{\#BANKS}$$

$$SHAREASSETS = \frac{ASSETS CONNECTED BANKS}{ASSETS ALL BANKS}$$

$$FRACBANKERS = \frac{\#MATCHES}{\#BANKERS}$$

$$PREVALENCE = \ln \left( \frac{\#ACTUAL MATCHES}{\#EXPECTED MATCHES} \right)$$

▶ [Jump to formula](#)

# Measuring the connection between politicians and bankers

Country	<i>ALL BANKS</i>				<i>FULLY PRIVATE</i>			
	<i>FRACBANK</i>	<i>SHAREASSE</i>	<i>FRACBANK</i>	<i>PREVALEN</i>	<i>FRACBANK</i>	<i>SHAREASSE</i>	<i>FRACBANK</i>	<i>PREVALEN</i>
	(1)	(2)	(3)	(4)	(6)	(7)	(8)	(9)
Switzerland	0.5	0.0	0.03	4.77	0.6	0.0	0.04	4.96
Japan	0.6	0.2	0.04	5.95	0.6	0.2	0.04	5.98
Italy	1.0	8.5	0.10	6.47	0.7	1.8	0.04	5.65
United States	1.1	7.5	0.08	7.82	0.8	7.4	0.05	7.32
Germany	1.1	3.1	0.05	6.56	0.6	0.9	0.02	5.69
Spain	1.2	15.1	0.05	5.67	1.3	15.1	0.06	5.75
Argentina	1.2	0.3	0.28	7.09	0.0	0.0	0.00	.
France	1.3	4.2	0.03	5.40	1.4	4.2	0.03	5.45
United Kingdom	1.5	0.1	0.11	6.90	1.6	0.1	0.12	6.98
Australia	2.2	2.1	0.25	6.73	0.0	0.0	0.00	.
Belarus	45.5	84.4	4.35	8.59	37.5	62.2	4.05	8.52
Cameroon	50.0	84.3	3.70	8.86	50.0	84.3	3.70	8.86
Malta	50.0	52.8	4.88	6.16	0.0	0.0	0.00	.
Rwanda	50.0	52.4	4.76	8.51	50.0	52.4	4.17	8.37
Angola	66.7	66.2	8.00	9.76	.	.	.	.
Burundi	66.7	64.0	8.22	8.61	33.3	8.9	3.33	7.71
Madagascar	66.7	67.6	6.25	9.23	100.0	29.0	14.29	10.05
Gabon	100.0	100.0	9.52	7.75	.	.	.	.
Georgia	100.0	100.0	8.00	8.48	100.0	100.0	8.00	8.48
Myanmar	100.0	.	18.75	11.93	100.0	.	18.75	11.93
Total	10	12	1	7.58	9	7	1	7.52

# The correlates of connectedness

## Correlation with bank characteristics

$$Y_{i,c} = \alpha + \beta \text{CONNECTED}_{i,c} + \gamma \text{SIZE}_{i,c} + \theta_c + \epsilon_{i,c}$$

	Dependent Variable			
	Total	Return	Equity	NCO /
	Assets	On Avg	/ Tot	Averag
	(1)	(2)	(3)	(4)
<b>B.1 All Banks</b>				
<i>Connected</i>	0.3358** (0.1349)	0.0062** (0.0025)	0.0225** (0.0105)	-0.0054* (0.0023)
Obs	3312	3285	3311	1176
R2	0.635	0.150	0.329	0.294
<b>B.2 Private Banks</b>				
<i>Connected</i>	0.3131* (0.1600)	0.0079** (0.0031)	0.0284*** (0.0108)	-0.0050* (0.0026)
Obs	2845	2819	2845	1016
R2	0.611	0.145	0.324	0.239

# The correlates of connectedness

Correlation with country characteristics: Overall Development

$$Y_c = \alpha + \beta \text{CONNECTEDNESS}_c + \gamma X_c + \epsilon_c$$

Measure	Controls: None			Controls: pop, % tertiary education		
	Coef/SE	N	R2	Coef/SE	N	R2
	(1)	(2)	(3)	(4)	(5)	(6)
<b>Panel B: 100% Private Banks</b>						
<i>FRACBANKS</i>	-2.673*** (0.678)	64	0.215	-0.848* (0.433)	63	0.814
<i>SHAREASSETS</i>	-1.425*** (0.490)	61	0.061	0.167 (0.271)	60	0.796
<i>FRACBANKERS</i>	-20.72*** (3.230)	64	0.26	-8.004*** (2.195)	63	0.827
<i>PREVALENCE</i>	-0.534*** (0.0530)	64	0.436	-0.203*** (0.0717)	63	0.829

# The correlates of connectedness

## Institutions

Measure	Control of Corruption						Voice and Accountability					
	Controls: None			Controls: log real GDP, log population			Controls: None			Controls: log real GDP, log population		
	Coef/SE	N	R2	Coef/SE	N	R2	Coef/SE	N	R2	Coef/SE	N	R2
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
<b>Panel A: All Bankscope Banks</b>												
<i>FRACBANKS</i>	-2.377*** (0.435)	79	0.21	-1.230*** (0.371)	79	0.72	-2.168*** (0.556)	79	0.23	-1.264*** (0.440)	79	0.58
<i>SHAREASSETS</i>	-1.575*** (0.379)	76	0.15	-1.012*** (0.285)	76	0.73	-1.539*** (0.368)	76	0.17	-1.076*** (0.304)	76	0.62
<i>FRACPOLITICIANS</i>	-25.19*** (3.691)	79	0.26	-13.30*** (3.897)	79	0.72	-22.42*** (4.308)	79	0.27	-13.19*** (3.962)	79	0.58
<i>PREVALENCE</i>	-0.473*** (0.0575)	79	0.43	-0.263*** (0.0636)	79	0.73	-0.393*** (0.0491)	79	0.38	-0.330*** (0.0718)	79	0.63

# The correlates of connectedness

## Regulation

Measure	Pro-Banker Regulation Index						Regulatory Quality					
	Controls: None			Controls: log real GDP, log population			Controls: None			Controls: log real GDP, log population		
	Coef/SE	N	R2	Coef/SE	N	R2	Coef/SE	N	R2	Coef/SE	N	R2
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	
<b>Panel A: All Bankscope Banks</b>												
<i>FRACBANKS</i>	5.055*** (1.456)	51	0.25	1.733 (2.142)	51	0.49	-2.175*** (0.456)	79	0.29	-1.401*** (0.362)	79	0.68
<i>SHAREASSETS</i>	3.818*** (0.888)	48	0.26	2.360** (0.963)	48	0.57	-1.593*** (0.339)	76	0.24	-1.190*** (0.332)	76	0.70
<i>FRACPOLITICIANS</i>	54.51*** (18.31)	51	0.33	28.71 (25.83)	51	0.52	-23.82*** (3.833)	79	0.38	-17.35*** (3.721)	79	0.72
<i>PREVALENCE</i>	0.491*** (0.0968)	51	0.25	0.362** (0.170)	51	0.53	-0.349*** (0.0475)	79	0.38	-0.241*** (0.0739)	79	0.67

# The correlates of connectedness

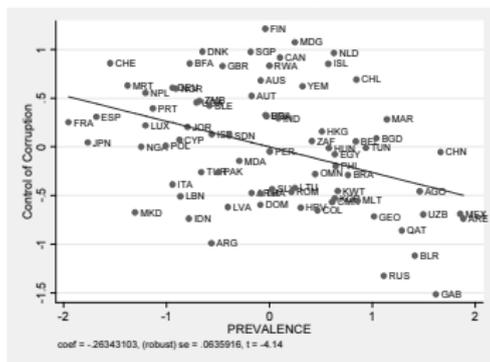
## Financial development

Measure	I. Controls: None			II. Controls: log population, log real GDP per capita (PWT)			III. Controls: log population, creditor rights, accounting		
	Coef/SE	N	R2	Coef/SE	N	R2	Coef/SE	N	R2
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
<b>Panel A: All Bankscope Banks</b>									
<i>FRACBANKS</i>	-2.905*** (0.512)	70	0.276	-0.844 (0.526)	70	0.63	-3.275*** (0.575)	59	0.382
<i>SHAREASSETS</i>	-2.189*** (0.381)	67	0.219	-1.039** (0.404)	67	0.65	-1.961*** (0.544)	56	0.333
<i>FRACPOLITICIANS</i>	-33.95*** (5.164)	70	0.419	-15.13** (6.581)	70	0.657	-34.57*** (7.436)	59	0.421
<i>PREVALENCE</i>	-0.412*** (0.0703)	70	0.268	-0.229** (0.0870)	70	0.651	-0.466*** (0.0849)	59	0.413

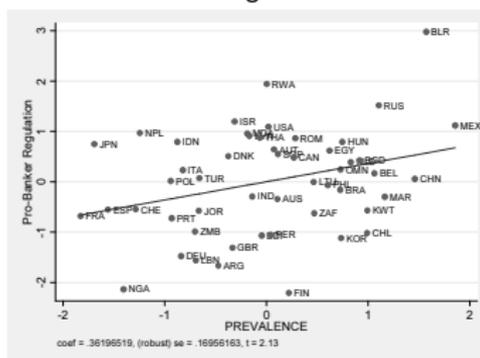
# The correlates of connectedness

## Figures

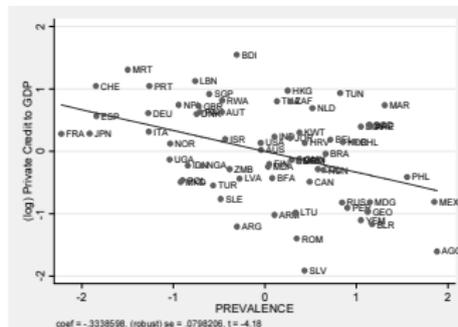
### Control of corruption



### Pro-banker regulation index



### Financial development



# The correlates of connectedness

## Robustness

- Differences in size of elite as fraction of population (proportional to fraction of population with tertiary education)
- Re-building all measures using only 10 largest banks (controlling for variation in # banks)
- Countries with more than 2 matches only
- Robust regression and dropping former socialist countries
- Including countries with zero matches but more than 2 banks

# Concluding remarks

- Extensive dataset on the connection between high level politicians and banks (available)
  - Just one potential form of connection
- Connected banks do better
  - Larger and more profitable without taking more risk
  - Circumstantial evidence that this is not because politicians go to good banks
- At the country level, connections are more prevalent where:
  - Brokering deals is less costly and governments less accountable
  - Regulation tends to be less market friendly and more pro-incumbent
  - The financial (and economic) system tends to be less developed
- Not causal evidence, but hard to reconcile with the alternative view that connections are an efficient allocation of human capital
- Further (ongoing work)
  - Measuring changes in connections (gather data as of 2010)
  - Role of connections on the crisis (performance, bailouts, etc.)

THANK YOU!

# Measuring the connection between politicians and bankers

How to compute the number of expected matches

◀ Back

- “Random” model: random sampling with replacement (first choose  $n_b$  bankers, replace, and then choose  $n_p$  politicians), from an “elite” of size  $N$

$$P(X = k) = \frac{\binom{N}{k} \binom{N-k}{n_p-k} \binom{N-n_p}{n_b-k}}{\binom{N}{n_p} \binom{N}{n_b}}$$

- It can be shown that  $E(X)$  is proportional to  $N$ . Baseline measure with  $N$  equal whole population