“Politics in Financial Intermediation: Evidence from Brazil”

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What the paper is about

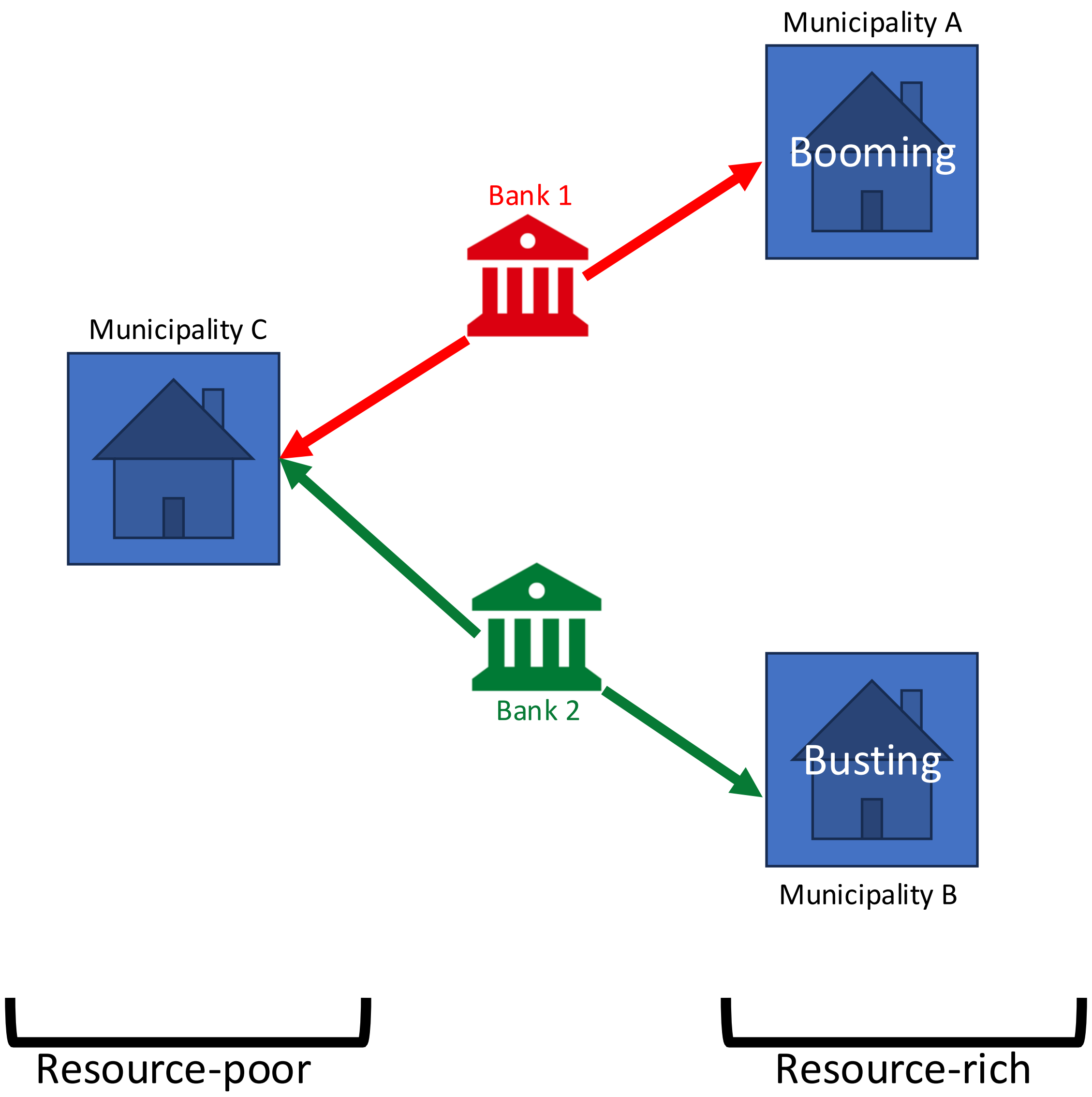
- **Focus:** How do banks re-allocate resource-endowment-driven liquidity from resource-rich to resource-poor regions? Is there a role for political incentives?
- **Data**:
  - Banking data from Brazil at *bank x municipality x year* level for the years 2001-2022.
  - Merged with initial (2000) natural resource endowments at municipality level and their prices over time (indexed)
  - Merged with local election data over the sample period
- **Results**:
  1. Banks exposed to resource booms experience an increase in their deposit levels in general.
  2. Banks exposed to resource booms experience an increase in their credit levels in both resource-rich and resource-poor municipalities.
  3. State-banks exposed to resource booms give relatively more credit in municipalities politically aligned with the President's coalition.
  4. "Political lending" effects seem to be driven by electorally popular and left-wing allies but not by electoral timing incentives.

First impression

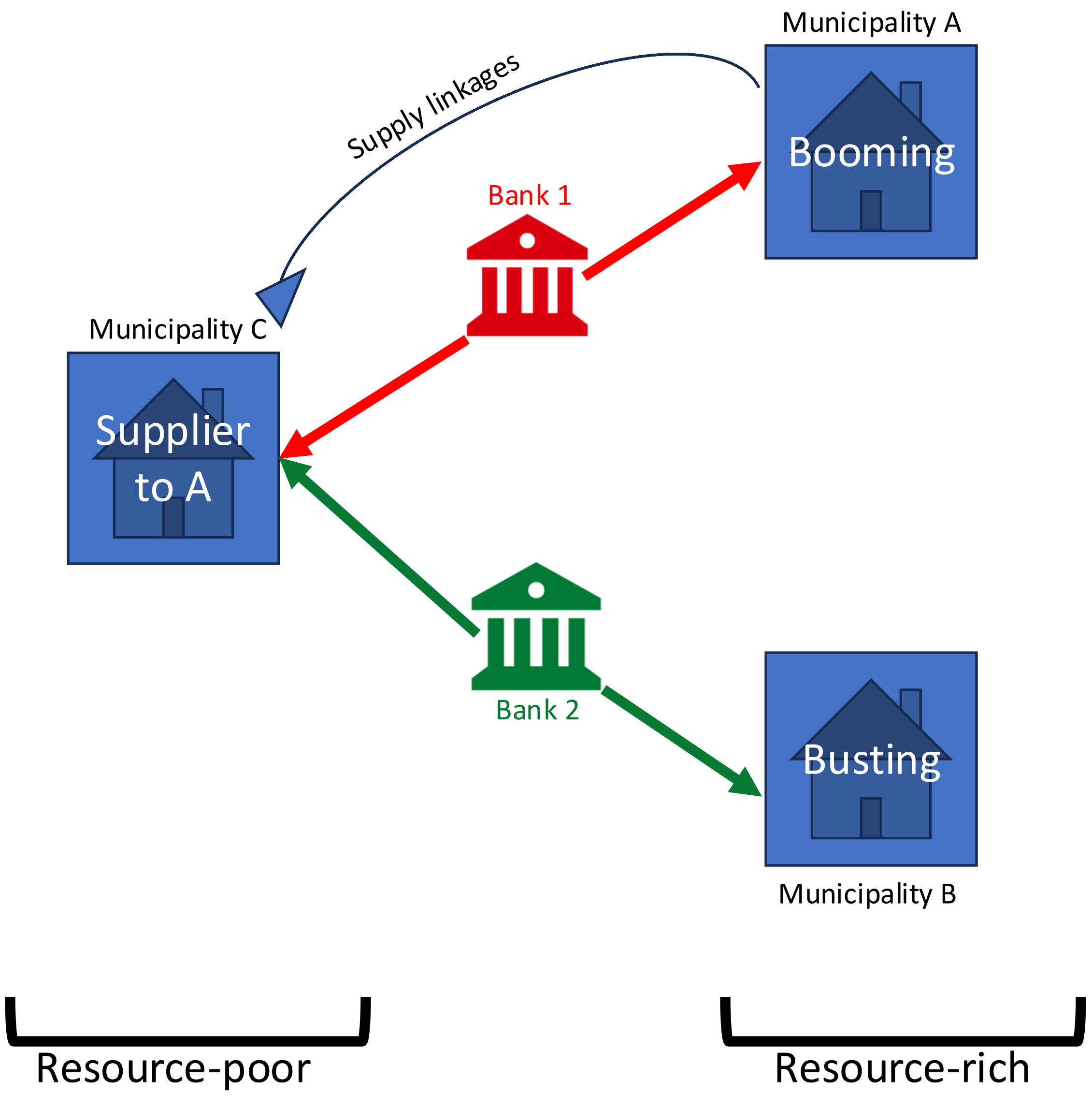
- Very nice idea: to merge the liquidity windfall literature with the political finance

- Results are supportive of political favoritism
  - I buy the main result; though mechanism needs further investigation

Comment 1: Bank specialization & supply linkages



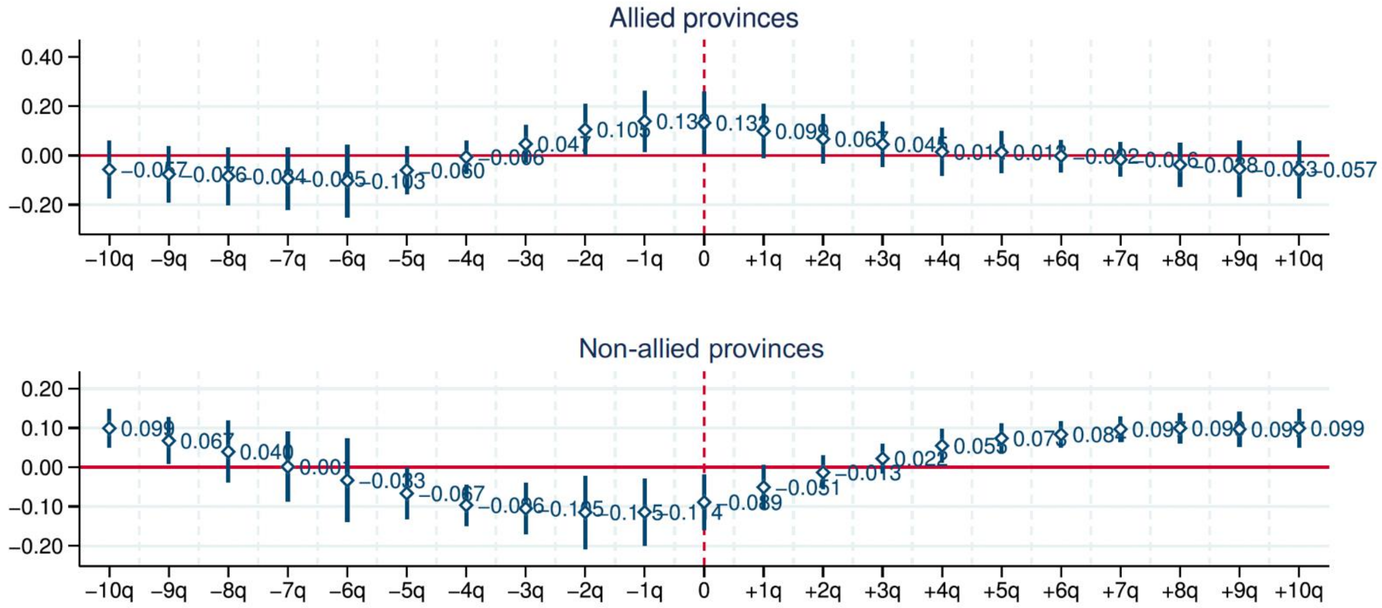
Comment 1: Bank specialization & supply linkages



- Assuming bank specialisation in sectors/geographies, bank-specific loan demand might confound the results.
- Existing robustness checks are not convincing.
- **<u>Cheap suggestion</u>**: Check for ex-ante bank-municipality specialisation interacted with the resource boom exposure.
- **<u>Serious suggestion</u>**: Find more data to link sectors, banks and municipalities and explicitly control for this channel.

Comment 2: Lack of electoral incentives

Bircan & Saka (2021, EJ)



- *Bircan & Saka (2021 EJ)*: Dynamic effects of electoral lending in Turkey
- This paper:
  - No electoral time variation in extra lending of state-banks to allied municipalities
  - Smaller effects for allied municipalities that were narrowly won (i.e., competitive races)
- Nice for contribution ☺ but not so good for the political narrative ☹
- Questions:
  - Do Brazilian politicians not use banks for electoral purposes? (but Carvalho, 2014, JF?)
  - What is the mechanism then if this additional lending is not used for electoral purposes?
  - <u>**Suggestion**</u>**:** If the dynamic effects are not so important, why not try RDD to push causality?

Comment 3: Mechanism (more general)

- Main mechanism: "For these and other banks that are majority-owned by the central government, the CEO and the board of directors are traditionally appointed by the president. This opens the door for substantial political influence on lending decisions."
- Questions:
  - What is the mechanism through which provincial (state) government and their banks will support the President's allies?
  - Why does it not matter if the ally is from President's party or from a different party in President's coalition? (Anecdotally this would matter big time in Turkey – AKP vs. MHP)
  - What drives left-wing > right-wing > centrists = 0 ?
- **Suggestion:** Drop the provincial state-banks from the baseline sample.
  - A robustness check shows larger effects, which favours the mechanism above.

Minor Comments

- Can you re-run the deposit results with resource-rich and resource-poor sub-samples?
  - If the results are really being driven by the former, it would be in line with your argument.
- Could foreign private banks be a better counterfactual?
  - Less likely to bow in front of the President?
- How do the results change if you only keep banks that have some exposure to resource booms (41 or 45)?
  - Current sample includes banks who never get exposed to resource booms.
- *Bank x Time FEs* for the estimation with triple-interaction?
  - Significance not important but nice to see how coefficient size changes.
- Economic size of the "political lending": 1/10 of the baseline effect.
  - Needs more discussion.

Overall

- Very interesting paper with a novel idea and dataset
- Can contribute more to the literature if it can sufficiently differentiate itself from the previous papers while still convincingly explaining the mechanism
- Looking forward to reading the next version ☺