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Bank Lobbying: Regulatory Capture and Beyond

by Deniz Igan and Thomas Lambert

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I N T E R N A T I O N A L M O N E T A R Y F U N D

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Research Department

Bank Lobbying: Regulatory Capture and Beyond

Prepared by Deniz Igan and Thomas Lambert[†]

Authorized for distribution by Maria Soledad Martinez Peria

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Abstract

In this paper, we discuss whether and how bank lobbying can lead to regulatory capture and have real consequences through an overview of the motivations behind bank lobbying and of recent empirical evidence on the subject. Overall, the findings are consistent with regulatory capture, which lessens the support for tighter rules and enforcement. This in turn allows riskier practices and worse economic outcomes. The evidence provides insights into how the rising political power of banks in the early 2000s propelled the financial system and the economy into crisis. While these findings should not be interpreted as a call for an outright ban of lobbying, they point in the direction of a need for rethinking the framework governing interactions between regulators and banks. Enhanced transparency of regulatory decisions as well as strengthened checks and balances within the decision-making process would go in this direction.

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Authors' E-Mail Addresses: digan@imf.org; t.lambert@rsm.nl

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Even if social welfare could be defined, and methods of maximizing it could be agreed upon, what reason is there to believe that the men who run the government would be motivated to maximize it? To state that they “should” do so does not mean that they will.

Anthony Downs (1957, p. 136)

I. INTRODUCTION

Lobbyists play a pervasive role in the U.S. political system. They attempt to sway the opinion of legislators and regulators on specific issues, using their expertise, network connections, persuasion, public relations skills, or some combination thereof. While in principle any private interest group could find a use for services of lobbyists, the majority of lobbyists in Washington represent business interests (de Figueiredo and Richter, 2014; Drutman, 2015). Lobbyists literally move business interests forward. They do so by providing policy research, sponsoring think tanks, mobilizing grassroots constituencies, building and maintaining relationships with key decision-makers and influencers, drafting and amending bills, and assisting agencies in writing complex rules.

The more complicated the policies (and policy-making processes) are, the more valuable the activities performed by lobbyists become. Lobbyists greatly gain from policy complexity because it offers them room to insert narrow provisions into legislation under discussion with limited public scrutiny and because it gives them an advantage when it comes to providing legislators and regulators with information and expert opinion.

It is therefore not surprising to see many lobbyists actively working for the banking industry as it is one of the most heavily regulated and supervised industries. Copious and complex regulations define acceptable behavior and shape the environment in which banks operate. A supervisory system encompassing both on-site and off-site elements aims to ensure compliance with these rules. At the same time, banks perform important functions for the economy—producing ex-ante information on investment opportunities and allocating capital, monitoring investments and exerting corporate governance, facilitating risk management, mobilizing savings, and easing transactions—and, as a result, any dysfunction in the banking system may pose significant risks for the entire economy (in the form of financial crises and through macro-financial linkages) with large socio-economic, and possibly political, costs.

It is thus imperative to understand not only how regulation and supervision affect bank decisions and performance, but also how regulation can be influenced by the banking industry itself. An expansive literature has examined the first part of this question, namely, the effects of regulatory and supervisory actions on bank activity, including efficiency and risk taking.¹ Research on the second part, by comparison, has been scarce but has gained momentum in the wake of the global financial crisis. In these studies, the concept of *regulatory capture*,

¹ See, for example, Buch and DeLong (2008), Laeven and Levine (2009), Barth et al. (2013), Berger and Bouwman (2013), Ongena, Popov, and Udell (2013). For more on the theoretical and empirical aspects of bank regulation and supervision, see also Barth, Caprio Jr., and Levine (2006, 2012), Admati and Hellwig (2013), and Myerson (2014).

introduced in modern economic analysis by Stigler (1971), received particular attention. Regulatory capture arises when banks exert excessive influence on the regulators such that regulators act primarily in the interest of the industry they regulate rather than in the public interest (dal Bó, 2006). In this context, regulators are not only the agencies establishing and enforcing the final rules by which banks need to abide but also the legislature whose actions form the basis for these rules. Hence, we use the term “regulatory capture”² to encompass “legislative capture” whereby elected representatives are also motivated by pursuing private interests of the regulated industry instead of the public interest.³

In this paper, our goal is to discuss whether and how bank lobbying in the United States leads to regulatory capture. In Section II, we provide an overview of the importance of bank lobbying in the United States and further highlight some empirical characteristics. In Section III, we discuss the motivations behind bank lobbying by outlining a conceptual framework of regulatory capture. In Section IV, we examine the impact of lobbying on financial regulation and supervision by reviewing recent empirical evidence. We close Section IV by presenting evidence on the effect of the rising political influence of the banking industry on the global financial crisis. Finally, we conclude in Section V with policy implications.

II. BANK LOBBYING IN THE UNITED STATES

In the United States, special interest groups, including the banking industry, can legally influence the policy formation process by carrying out lobbying activities in the executive and legislative branches of the federal government. Some hire lobbying firms; others have lobbyists working in-house. These lobbying activities dwarf campaign contributions:⁴ the whole

² A related concept is “intellectual capture,” loosely defined as the inability or difficulty to question the tenets of the dominant viewpoint in a field and adoption of someone else’s views as one’s own. To put it more concretely, those working in regulated firms make regular contact with regulatory agencies while few members of the general public do. As a consequence of such regular interaction, regulators’ mindset would more closely resemble that of the industry representatives and groupthink would take hold, making it difficult to come up with or voice unconventional ideas. Hence, identification with the regulated ends up in rationalization and institutionalization of industry views as the regulator’s view. Ultimately, the society as a whole may start believing that what is good for the regulated industry is good for all (see, e.g., Brandl, 2016). While captivating, intellectual capture is hard if not impossible to appraise. That said, lobbying is an obvious channel through which intellectual capture may materialize. For discussions on the conceptions of capture, their mechanisms and outcomes, see Carpenter and Moss (2013).

³ It is important to emphasize upfront that regulatory/legislative capture, in the way we interpret it here, does not imply corruption. The latter has been defined in many ways but almost always involves the abuse of public office for private gain often through illegal means such as bribery and theft.

⁴ In the U.S. campaign finance system, electoral campaigns can gather funding from various sources including public funds, political party and candidate’s own funds, and private contributions from individuals and businesses. Political action committees (PACs) solicit money from employees or members and make contributions in the name of the PAC to candidates and political parties. Individuals contributing to a PAC may also contribute directly to candidates and political parties. PAC and individual contributions are “hard money” and are subject to limits: a PAC can give \$5,000 to a candidate per election and up to \$15,000 annually to a national political party. PACs may receive up to \$5,000 each from individuals, other PACs and party committees per year while individuals may contribute \$2,700 per election to candidates, \$5,000 per year to a PAC, and \$33,400 per year to a political party (as of 2016). Contributions made outside these limits are labeled “soft money” and, while unlimited in

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financial sector (encompassing finance, insurance, and real estate companies) spent \$7.4 billion on lobbying in the period that ran from 1998 to 2016.⁵ In light of the bulk of these politically-targeted expenditures, they have received insufficient attention in the literature as compared to campaign contributions, in part owing to the scarcity of data on who lobbies and by how much.⁶ Public scrutiny and academic interest in lobbying has increased since the public disclosure of data on lobbying became regular, thanks to the passage of the Lobbying Disclosure Act of 1995 (LDA), which requires lobbyists to provide a substantial amount of information on their activities. In particular, lobbyists have to disclose the dollar amounts they receive from their client, and the issue areas as well as agencies they target. This information makes clear the economic motives of lobbying expenditures, which are unlike campaign contributions in that the latter may also reflect partisan or ideological motives. We provide in the appendix a description of the reporting and recording of lobbying data and some indications for their use in empirical research.

The disclosure of lobbying expenditures gives us a good measure of the size of the bank lobbying market during the past twenty years. The question is thus: how much do banks lobby? At first sight, a short answer would be quite a lot. Within the financial sector, the leading industries in lobby spending are insurance, securities and investment, and real estate (see Figure 1).⁷ Banks—encompassing commercial banks, credit unions, savings and loans, and mortgage bankers and brokers—come as fourth, having spent a total of \$1.2 billion over the period between 1998 and 2016. This is likely a lower bound for lobbying spending on issues that affect banks because part of the activity is reported under the parent organization—which

amount, are subject to rules under the Bipartisan Campaign Reform Act of 2002 (BCRA) on how they can be used. Note however that, in the years that followed, federal court decisions, including *Citizens United v. Federal Election Commission*, have eroded parts of the BCRA, giving rise to super PACs and “dark money” organizations—politically active nonprofits that do not have to disclose their donors. We refer the interested reader to the Center for Responsive Politics (CRP, www.opensecrets.org) for more on campaign finance basics and definitions.

⁵ Based on data compiled by the CRP. Between 1998 and 2016, the whole financial sector contributed \$675 million to PAC contributions, making the financial sector a top contributor along with other regulated sectors (e.g., utilities) and sectors that tend to be government-dependent (e.g., healthcare). By comparison, the utilities sector (encompassing communications, energy, and natural resources) contributed \$521 million while the healthcare sector contributed \$465 million. The financial sector has also been the biggest spender in individual contributions and soft money. In total (counting individual contributions and soft money), the financial sector outspent all others by pouring \$4.6 billion to elections. Utilities and healthcare have been distant runners-up at \$2.3 billion and \$1.5 billion, respectively.

⁶ A partial list of campaign finance studies includes: Hart (2001), Wawro (2001), Kroszner and Stratmann (2005), de Figueiredo and Edwards (2007), Cooper, Gulen, and Ovtchinnikov (2009), Akey (2015), Kalla and Broockman (2016).

⁷ It is worth noting that the biggest clients in the insurance industry are often attached to the healthcare sector (e.g., Blue Cross/Blue Shield and America’s Health Insurance Plans).

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may be recorded as a securities and investment company—and some seemingly unrelated industries may also lobby on issues directly related to banks.⁸

Lobbying by banks increased in absolute terms over most of this time period, rising from a trough of \$36.3 million in 1999 to a peak of \$88.2 million in 2014. When scaled by the industry value added (i.e., gross domestic product by industry), this pattern remains largely unchanged (see Figure 2). Interestingly, the growth in bank lobbying expenditures during the period was faster than that of other financial industries. This difference can perhaps be explained by two major factors. First, the real estate industry—a major contributor to overall financial sector lobbying—considerably cut down on lobbying during the Great Recession. Second, legislative and administrative activity picked up significantly for banks during the global financial crisis and remained intense following the passage of the Dodd-Frank Act in 2010.

Banks' lobbying expenditures declined somewhat during the period 2015–16, to an annual average of \$86.3 million. The decline looks more pronounced in relative terms since the industry value added continued to grow in these years. That said, this decline in lobbying activities of the banking industry has coincided with a decline in total lobbying spending.⁹

Although the size of the bank lobbying market looks big according to these nominal figures and by comparison to other industries, when we contrast them with the size of the banking industry, it is rather the opposite that prevails.¹⁰ For example, in 2016 Citigroup Inc. spent \$5.47 million in lobbying, while it reported \$17 billion in revenues for the fourth quarter 2016 only. In a same vein, if we compare the total lobbying expenditures made by banks with the value of policies and benefits at stake, again these numbers are rather small.

These comparisons raise a puzzle: why do special interest groups spend so little in politics? This puzzle has been debated at length in the literature, and most prominently by Tullock (1972). We underscore here three important considerations accounting for this puzzle in bank

⁸ For instance, in 2016, the National Retail Federation lobbied on seven specific issues that fell under the general issue category of banking. These issues included implementation of mobile payment systems, data security and breach notification, and competition in debit routing and other payment innovation.

⁹ One possible reason for this generalized decline may be the political gridlock that characterized Congress in these years. Yet, the gridlock started earlier and Congress actually enacted more laws in 2015–2016 than it did in 2013–2014 or 2011–2012 (www.govtrack.us/congress/bills/statistics). Other factors likely played a role: energy and natural resources sector recorded the largest drop in lobbying spending, coinciding with the oil price slump.

¹⁰ However, it is quite likely that our numbers significantly underestimate the real size of the bank lobbying market. The definition of a lobbyists by the LDA is narrow enough to allow many people who are actually engaged in lobbying to not register as such—the major loophole being “20 percent of the time” an individual should at least spend on lobbying. Indeed, recent reports suggest that the underworld of hidden lobbying is bigger than what formal disclosures and registries reveal. LaPira and Thomas (2013) estimate that the actual total amount spent on hidden lobbying is probably as big as the amount spent on “registered” lobbying. See also Guy Rolnik, “Uber, the Mayor’s Private Email, and the Underground Lobbying Complex,” <https://promarket.org>, February 28, 2017; and Guy Rolnik, “How Many Newt Gingrich’s Are There in Washington? Much More Than You Might Think,” <https://promarket.org>, April 3, 2017.

(continued...)

lobbying (see also Ansolabehere, de Figueiredo, and Snyder, 2003; and Zingales, 2017). One is that the interests of the banking industry are aligned and well-organized, while it faces a diffuse, unorganized opposition (i.e., the general public). Therefore, special interest groups need not spend much money to further push for their particular interests. Another consideration relates to the informational content of lobbying. Special interests do not need to spend much because once they reach out the legislator or regulator and provide them with the key, relevant piece of information, the value of all additional information is basically zero. For example, for a congressman the key piece of information could be the impact of his vote for or against a particular bill on his reelection prospects, while for a regulator it could be about the chances of getting her appointment renewed or about the odds that a strict stance could prompt banks to go “charter shopping” and potentially engender a race-to-the-bottom among regulators.¹¹ Our third consideration is about the idea that lobbying expenditures are supplemented by other mechanisms of influence such as quid pro quo agreements, career concerns, relationships, and persuasion. Although lobbying may encompass some of these mechanisms, lobbying *money* only facilitates the purchase of access to legislators and regulators. In a recent study, Brown and Huang (2017) analyze the Obama Administration’s White House visitor logs from 2009 to 2015. Identifying 2,286 meetings between federal government officials and corporate executives from S&P 1500 firms, they show that firms having access to high-level federal government officials experience higher stock price performance. Consistent with this notion that money buys access, the authors also find that firms that spent more heavily on lobbying and contributed more to Barack Obama’s presidential election campaigns had an increased probability of gaining access to influential federal officials at the White House.

The relatively small size of the bank lobbying market is also explained by its breadth. Only a small number of (big) banks actually lobby.¹² The existence of barriers to entry for the lobbying process accounts for this empirical regularity. In particular, high fixed costs and returns to experience both act as barriers to entry (Kerr, Lincoln, and Mishra, 2014). The fixed costs include the costs of creating a government affairs department, hiring the right lobbyists and educating them about the bank’s interests. These are also the resources necessary to develop a lobbying agenda and a strategy for influencing the complex political process. Lobbying experience can also be viewed as a barrier to entry because experience is necessary to establish a continuing relationship with legislators and regulators and to become more effective at lobbying them. These barriers to entry induce persistence in lobbying. Firms tend to stay in the lobbying process once they get into it because they do not want to incur these fixed costs to set up a lobbying operation again in the future. Drutman (2015, p. 2) writes in this respect: “Once companies encamp on the Potomac, they rarely depart.”

¹¹ Charter shopping refers to the argument that a complex, multi-regulator system may generate regulatory arbitrage by incentivizing banks to change their charter to pick regulators that are laxer. See, for instance, Agarwal et al. (2014). See also Jessica Silver-Greenberg, “Small Banks Shift Charters to Avoid U.S. as Regulator,” *New York Times*, April 2, 2012.

¹² Bombardini (2008) shows that industries, such as the banking industry, with a higher share of firms above a certain size exhibit higher intensity of lobbying activity.

III. BANK LOBBYING AND REGULATORY CAPTURE: A CONCEPTUAL FRAMEWORK

After having explained the importance of bank lobbying, we now turn to the reasons why banks lobby. For this purpose, we use a conceptual framework to clarify how lobbying can lead to regulatory capture. This conceptual framework, shown in Figure 3, is adapted from Mitnick's (1980) seminal work and also partly draws from Dockner (2014).

Figure 3 presents the players involved—the legislature, the regulator put in place by the government, and banks, that is, the regulated industry. The role of all these players are intertwined in a complex way, so the arrows of the figure indicate the two-way interactions between each of them, with the first best solution of the system serving the public interest (i.e., Panel A). It is not trivial to identify what the public interest is, and it is beyond our scope to do so, but we refer to it as the economic welfare of agents referenced in the system. Our purpose here is not to provide a complete description of this system and its first best solution, but is rather to show how regulatory capture through lobbying comes up from it.

The role of the legislator is to design rules in such a way that economic agents (here banks) behave and take actions best-serving the public interest. Because in the real world information asymmetries and externalities are present, the regulator comes into play in order to implement and enforce these rules again with the objective of supporting the public interest. The arrows in Panel A going from banks to either the legislator or the regulator primarily indicate the flow of information transmitted between these players. In this regard, bank lobbying plays a crucial role from a public interest standpoint as it enables the transmission of information. This information is deemed to be expertise-related or private to banks by the regulator/legislator, who then can act accordingly.¹³

However, capture can also arise in this framework: when the interests of the regulator (or the legislator) are in conflict with the public interest and serve instead that of banks.¹⁴ In other words, regulatory capture is characterized by a situation in which the regulator/legislator and the regulated industry collude and maximize the sum of their own returns at the expense of the public interest. In terms of Figure 3 from above this is exhibited in Panel B, which stresses the collusion between the regulator or legislator alike, and the banking industry.

The economic drivers of regulatory capture have their roots in the same concepts that drive the need for regulation: information asymmetries and externalities. In practice, these economic

¹³ See Grossman and Helpman (2001) for detailed discussions on the informational role of firm lobbying.

¹⁴ The definition of the OECD Guidelines for “managing conflict of interest in the public service” (OECD, 2003, p. 13) reads as follows: “A “conflict of interest” involves a conflict between the public duty and private interests of a public official, in which the public official has private-capacity interests which could improperly influence the performance of their official duties and responsibilities.”

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drivers operate through two main channels: career concerns of the regulators and the regulator's need for information that can only be provided by the industry (Zingales, 2013).¹⁵

To illustrate the first channel, suppose regulators aim to maximize their lifetime earnings.¹⁶ If public-sector salaries are on average lower than those paid in the private sector, regulators would have an incentive to establish their expertise as well as their networks within the industries they regulate. When the right opportunity presents itself, a regulator would leverage the network connections she has built to increase her chances of getting a job offer.¹⁷ In this context, having a track record of being “industry friendly” may be a useful asset.¹⁸ Another way regulators may increase their value to the private, regulated firms is to generate complex, industry-specific rules and regulations that would require a great deal of institutional knowledge and experience to navigate. The regulated firms might then find it attractive to hire ex-regulators to help them comply and avoid penalties.¹⁹

Turning to the second channel, for the regulator to do a good job and maximize her utility, she would require access to the same information set as the industry she is tasked to regulate/supervise. Given information asymmetries and in the absence of perfect disclosure, she may find herself trading preferential treatment for information.²⁰ A preferential treatment for banks can be a change in existing rules or policies, or the provision of private benefits in

¹⁵ Laffont and Tirole (1991) are the first to theoretically study regulatory capture in an analysis based on asymmetric information and the principal-agent model.

¹⁶ While this may seem obvious, there may be cases where the regulator's utility function puts non-negligible weight on, e.g., civic pride in serving the public.

¹⁷ The term “revolving doors” has been coined to refer to public office holders or public servants taking positions in the private industry and vice versa. See Che (1995) and Bond and Glode (2014) for theoretical developments on revolving doors and Lucca, Seru, and Trebbi (2014) and Shive and Forster (2017) for recent empirical evidence.

¹⁸ In systems with multiple regulators, such incentives may also arise because the budget of a regulatory agency depends in part on the number and size of banks it regulates and banks may switch agencies in their search for more lenient treatment (“charter shopping”). See, for instance, Rosen (2003) and Agur (2013) for more on the literature looking at such switching behavior and its implications.

¹⁹ Note that having complex rules and regulations does not necessarily mean having strict rules and regulations. Adding complexity may hurt firms by increasing compliance costs but helps the regulator in increasing the value of her expertise. As an additional consideration, complexity may actually be welcome by the regulated industry and the lobbyists it hires if it generates room for loopholes.

²⁰ This pertains particularly to financial infrastructure where information asymmetries can be extremely severe and, crucially, the builder/owner of the infrastructure have exclusive information about how and why these systems are designed the way they are. Differently from every other form of infrastructure, financial infrastructure—stock exchanges, the Consolidated Audit Trail, SWIFT, and payment systems like TARGET, CHIPS or CHAPS—are built and owned by financial institutions. For more on this, see Donald (2011).

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the form of bailout guarantees, privileged access to licenses (allowing market power and boosting charter values), or more lax treatment in supervision.²¹

Bank lobbying mostly operates through this second channel, as suggested by the arrows in Panel B of Figure 3 going from the banking industry to the legislator and the regulator, respectively.²² These arrows indicate that banks collude to obtain preferential treatment and suggest another definition of lobbying as a legal activity aiming at changing existing rules and procuring private benefits. This definition of lobbying is consistent with and in part builds upon the interest-group theories of regulation as developed by Stigler (1971), Peltzman (1976), and Becker (1983), which are also the basis for regulatory capture. In this context, lobbying is indeed arguably more conducive to being interpreted in a regulatory capture view than other forms of politically-targeted activities. This is because lobbying involves one-to-one interaction between industry and both legislative and executive branches of the government, including numerous agencies that exercise certain degrees of discretion in implementing and enforcing regulations. Campaign contributions, by contrast, would influence a smaller circle.

Furthermore, this second channel of regulatory capture works because all interest groups including the public do not have the same access to information and to influence as the regulated industry. Put in simpler terms, consider the case in which the regulator makes a mistake and puts in place regulation that fails to maximize total welfare (in a Pareto-efficient way) by favoring one interest group over the other. Given its superior access to information, the industry is more likely to know and expose the mistake while the public is unlikely to notice the mistake or react to it. In addition to the information gap, the public also faces a bigger free-rider problem, making it difficult to coordinate a reaction. This gives the regulator the incentive to err on the side of being more lenient to the industry. Banking regulators are particularly prone to such incentives because it is difficult for them to convince the public that there would have been a crisis but for their successful efforts to avoid it. Rather, it is easier for them to persuade the public that crises are the outcome of complex interplay among various factors—many of which the regulator cannot control.²³ Similarly, not all interest groups have the same level of access to influence. If lobbying by one interest group is perfectly matched by the lobbying of the opposing interest group, the regulator would not be swayed in favor of one or the other. However, access to influence is asymmetric across interest groups, especially in our context, because of the extent of the free-rider problem or the resources available for politically-targeted activities. The latter can be particularly important if there are fixed costs

²¹ Less often in the financial sector but quite prominently in the non-financial sector, firms may also benefit from preferential access to credit and procurement contracts (see, e.g., Claessens, Feijen, and Laeven, 2006; Faccio and Parsley, 2009; Goldman, Rocholl, and So, 2013; Agca and Igan, 2015; Brown and Huang, 2017).

²² The reason for the dominance of the second channel is two-fold. First, there is limited scope to influence supervisors by directly exploiting their career concerns as differences in job security may mitigate the effects of the pay gap between the public and private sectors. Second, the second channel could partially encompass the first as information is an essential component to effective supervision and possibly promotion decisions affecting supervisors.

²³ By comparison, in the aviation industry for example, it is more straightforward to pin point the reason for a crash, allocate the blame, and punish the responsible party. For more on this contrast between aviation safety and banking regulation, see Admati (2016).

involved (as seen in the previous section). These differences in access to both information and influence reinforce the effect of bank lobbying.

Empirical research is broadly in line with the regulatory capture view of (bank) lobbying. Bertrand, Bombardini, and Trebbi (2014) study the role of lobbyists in the United States and show that a pure informational (or expertise) view of lobbying is rather inconsistent with the data, whereas maintaining contacts to regulators and legislators to influence (capture) them is central to what lobbyists do. The next section summarizes some recent empirical findings of the literature specifically on bank lobbying and financial regulation, supervision, and outcomes in the United States. This summary is primarily based on four of our own studies: Igan, Mishra, and Tressel (2012), Igan and Mishra (2014), Igan et al. (2017), and Lambert (2018). It is noteworthy that the empirical literature on political connections (broadly defined) also confirms that politically-connected firms have an influence on the regulatory and supervisory framework that affects their industry but also have consequences on firm-specific economic outcomes (for a survey of the literature, see Lambert and Volpin, 2017).

IV. BANK LOBBYING AND REGULATORY CAPTURE: RECENT EVIDENCE

A. Banking Regulation

As laid out conceptually in the previous section, a primary reason for banks to engage in lobbying is to exert influence on the process through which regulations are put in place. The legislative branch of the government is often the first stop in getting regulations in place. The disclosure of information on lobbying allows study of whether and how a regulated industry influences the creation of regulations. This is because one can identify which legislative and regulatory proposals are targeted by lobbyists working for the industry. Igan and Mishra (2014) study this issue in the context of financial regulation between 1999 and 2006, that is, the run-up to the global financial crisis. The empirical analysis of that paper is set in the context of the federal law-making process in the United States, which is arranged as follows.

From the initial idea for a legislative proposal through its publication as a statute, the process is not a simple or short one. It is initiated by the introduction of a proposal in the form of a bill by a member/s of the House of Representatives or the Senate (“the sponsor” or the “co-sponsors”). Each bill must have a sponsor and may have a number of co-sponsors. If a bill ultimately reaches the floor,²⁴ the vote on it in either house of Congress may be done in one of

²⁴ After introduction by (co-)sponsor(s), the bills are referred to committees that deliberate, investigate, and, if necessary, revise them before they are accepted for general debate. Arguably, this is the most important phase of the process because, for the majority of bills, this marks the end of the road. The original bill, if not dead in a committee, often leaves the committee with several amendments. Once a bill is recommended by the committee(s) to which it was referred, it comes to the house of Congress that originated the bill for consideration and debate. At the end of the reading and discussion of the bill in its entirety, the originating house first votes on whatever amendments have been reported by the committee(s) and then immediately votes on the passage of the bill with the amendments it has adopted. If the bill passes, a copy, with all the amendments and in the exact same format that it was passed by the originating chamber, is sent to the other chamber of Congress. At this point, the measure technically ceases being a bill and becomes an act. It then goes through similar steps in the other house of Congress: referral to committee(s), debate, and vote. The original, together with the engrossed amendments, if any, from the second house, is then returned to the originating house with a message stating the action taken by

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three ways: voice vote (where the chair asks first for all those in favor of the motion to speak out, and then asks all those opposed to the motion also to say so), the division (where the members supporting and opposing the motion stand successively and are counted) and the written, recorded vote.

There are various points in the legislative process at which a legislator makes her stance on the proposed bill known to others. Obviously, recorded votes on passage constitute one such point, but not all bills get to this final stage. For those that do, roll call records for all senators and representatives are publicly available. For bills that never make it to the final voting stage (or do but do not have recorded votes), one can analyze the information from the earlier stages of the legislative process, namely, data on the sponsorships and co-sponsorships. The (co-)sponsorship of a bill usually translates into voting in favor of that bill.

Throughout the law-making process, lobbyists approach members of Congress—especially those in key committees, who tend to receive larger amounts in campaign contributions—and administrative offices to make a case for the support or opposition of a bill. Anecdotally, the sought outcome is the defeat (passage) of unfavorable (favorable) legislation. This is supported by lobbying reports, which occasionally spell out the client’s objective or position on an issue: for example, Bear Stearns reported that it “advocated the concepts in the proposal but not the proposal” in its filing regarding lobbying activities on the Mortgage Reform and Anti-Predatory Lending Act of 2007 (a bill that would have established stricter requirements and standards on mortgage loans) while Citigroup Inc. reported that it sought passage of the Bankruptcy Reform Act of 2001 (a bill that made it more difficult to file for individual bankruptcy). Albeit incomplete, this information can be used to make an educated guess on whether the banking industry would support or oppose a particular financial regulation proposal.

If efforts to influence the law-making process on behalf of the banking industry are successful, one would expect to see bills deemed favorable and supported through lobbying by the banking industry to have a higher likelihood of passage. By contrast, bills that are unfavorable would be defeated if the industry spent enough on lobbying to do so.

In an empirical set-up, the complication is that there are many other factors that may influence the ultimate fate of a financial regulation proposal. A possible solution is to focus instead on the voting and/or (co-)sponsorship patterns. To be more specific, one can use the actions of an individual legislator on a given bill to examine whether a legislator’s likelihood of taking a particular position or changing her previous position on a proposal relates to how much lobbying is done on the proposal. This would also allow one to control for a range of fixed effects to capture legislator characteristics (e.g., ideology) and the general political

the second. If there are any differences between the two versions, a conference may be called to resolve any disagreements or competing versions bounce between the two houses until the disputes on legislative text are resolved. Once an agreement on an identical form of the act is reached, a copy is presented to the President. A bill becomes law on the date of approval or passage over the President’s veto, unless it expressly provides a different effective date.

(continued...)

environment (e.g., anti- or pro-regulation sentiment). Of course, it would also be imperative to control for lobbying by the “other side,” that is, groups that are likely to advocate against the position of the financial industry.²⁵

Igan and Mishra (2014) explore the effect of lobbying by asking two main questions.⁴⁰ First, did lobbying by the financial sector have a link to the legislative outcomes of bills on financial regulation? Second, were legislators’ network connections with the lobbyists and the financial sector related to their decision to support certain proposals?

The authors construct a comprehensive dataset that combines firm-level data on lobbying expenditures targeting specific bills and on campaign contributions to particular legislators with information on employment histories of legislators and lobbyists hired to work on these specific bills to pin down the network connections among the legislators, lobbyists, and the financial sector. Then they gather detailed information on the 47 financial regulation bills that were considered in Congress between 1999 and 2006, including their provisions, so that they can be grouped into broad categories on the basis of their similarities (“tight” or “lax” bills that have common provisions). This categorization is important because their empirical strategy exploits the cases in which legislators switched positions on a given legislative proposal. In other words, they use the variation in bank lobbying at the bill level and the variation in the position taken by the same legislator on the same issue through its various incarnations. Hence, their econometric specifications, similar to Stratmann (2002), allow to identify whether an individual legislator’s switching her support for a particular bill is linked to the lobbying expenditures made by financial institutions affected by the bill.

Igan and Mishra (2014) first document that no tight bill passed both chambers of Congress and ultimately got signed into law, while 16 percent of the lax bills did. This difference is even more striking when individual bills are grouped into common concept categories. The majority of lax-regulation proposals were ultimately signed into law, whereas none of the tight-regulation proposals succeeded.

Next their empirical analysis reveals that both lobbying expenditures by affected financial institutions and network connections between lobbyists and legislators who worked on a particular bill are positively associated with the probability of a legislator changing positions in favor of deregulation.²⁶ In economic terms, a one-standard-deviation increase in lobbying

²⁵ Note that the discussion focused on the politically-targeted activities of the industry as a whole. An interesting question is how the incentives at the industry level are reflected at the individual bank level, given the free-rider problem. Why do individual banks lobby rather than free ride the industry-wide effort to influence regulation? The short answer is that not all banks are created equal and some have stronger incentives (and hence a lower threshold for fixed costs) to engage in these activities. Banks differ in their screening technology, underwriting and securitization techniques, specialization, or the capacity to acquire private information regarding future states of the world. Given these characteristics, some banks would have the incentive (and perhaps the capacity) to take more risk. These banks would also gain comparatively more from a relaxation of the regulatory rules that limit risk taking and, thereby, lobby on them, even if other banks may free ride and also benefit (but to a lesser extent) from lax regulations—a point we come back to in Section IV.C.

²⁶ Other evidence on the link between the political influence of the banking industry and financial regulation comes from an analysis of campaign contributions prior to the global financial crisis: Mian, Sufi, and Trebbi
(continued...)

expenditures is associated with an increase of 3.7 percentage points in the probability of switching, while lobbying by individuals who previously worked for a legislator is associated with an increase in the probability of switching of 2.5 percentage points. Further analyses show that network connections of legislators with the financial sector and certain legislator characteristics affect the strength of the relationship between lobbying and the probability of switching in favor of deregulation prior to the crisis. Specifically, they find that lobbying has a stronger link to moving support toward deregulation if the legislator has previously worked in the financial sector and if she has more conservative tendencies.

The documented correlation among lobbying, network connections, and voting patterns is robust to a battery of robustness tests, yet it does not translate directly to any particular causation story. The estimates lend themselves to several interpretations. First, lobbying firms may have better information than the legislators, and they partly reveal their information by endogenously choosing their lobbying effort, consistent with information-based view as discussed above in connection with Figure 3 (Panel A). Second, lobbying may simply be a reflection of the political negotiation process and good-faith compromise, also consistent with an information-based view. Legislation evolves as various interest groups lobby to garner support. The negotiations start with an extreme position and then slowly move toward compromise. Lobbying efforts on the earlier, more extreme versions of a bill may be small, focusing on the marginal legislator. As the bill evolves, more compromises are made, and lobbyists may elect to reach out to a broader set of legislators as the bill gravitates toward the center and becomes more appealing to them, which increases the odds of a position switch. Hence, more lobbying in a given round may coincide with more compromises being made and more votes being switched from the preceding round as a result of the negotiation process. Finally, a less benign story is that financial institutions lobby to buy off legislators, and in this case their motive for lobbying is to extract rents from them. In other words, lobbyists compete for influence over a policy by contributing to politicians strategically, consistent with the regulatory capture view as depicted in Panel B of Figure 3.

While it is difficult to firmly distinguish among these explanations, two additional pieces of evidence from the study deserve attention. First, the probability of switching does not increase systematically over successive incarnations (Igan and Mishra, 2014, Table 6), which raises doubt about the compromise explanation. Second, the result that legislators' employment

(2013) examine how different interest groups may have influenced U.S. housing policy during the subprime mortgage credit expansion that took place between 2002 and 2007. The authors measure "special interests" by campaign contributions from the mortgage industry and "constituent interests" by the share of subprime borrowers in a congressional district. They also use co-sponsorship information in addition to actual votes in their analysis. They first document that, beginning in 2002, mortgage industry campaign contributions increasingly targeted U.S. representatives from districts with a large fraction of subprime borrowers. During the expansion years, mortgage industry campaign contributions and the share of subprime borrowers in a congressional district increasingly predicted congressional voting behavior on housing-related legislation. This suggests that both lenders and borrowers influenced government policy toward housing finance during the subprime mortgage credit expansion. As mentioned earlier, while using campaign contributions has the attractiveness that they can be linked to particular legislators, they are mute on what the objective of the contributor is on a specific issue or proposal. Moreover, this analysis focuses on six bills selected on an ad hoc basis, rather than the more systematic analysis provided in Igan and Mishra (2014).

(continued...)

experience in the financial sector and use of connected lobbyists enhance the link between lobbying expenditures and voting patterns is consistent with the regulatory capture view and, hence, seems to support rent-seeking motives.²⁷

B. Banking Supervision

Looking back at Figure 3, the evidence discussed so far shows that bank lobbying affects the ability of the legislator to design proper rules: i.e., we have followed the arrows between banks and the legislature. Banks may also succeed in avoiding regulation by lobbying the regulator directly, so as to affect her ability to enforce the rules in place, as highlighted by the arrows of the figure going from banks to regulators and vice versa.

In a recent study, Lambert (2018) analyzes the relationship between bank lobbying and supervisory decisions of regulators by focusing on enforcement actions imposed by regulators on banks. More precisely, an enforcement action is initiated when regulators identify during their examination financial or managerial problems, or even violation of banking laws and regulations. Enforcement actions constitute key components of micro-prudential supervision as they require a troubled institution to take corrective measures. Such actions are meant to restore safety and soundness by stabilizing the institution, modifying its practices and risk-taking behaviors, and averting potential losses to the deposit insurer. Enforcement actions more or less directly translate into costs for the punished bank and its management (monetary penalties, partial loss of managerial control, loss of reputation, or potentially negative market reaction). Regulators can impose several types of enforcement actions that differ in terms of severity.

The supervisory process gives broad discretionary power to regulators in assessing the seriousness of a bank's problems and in determining whether (and which types of) enforcement actions should be taken. In his study, Lambert (2018) examines whether banks may interfere in the process by lobbying the regulator (i.e., the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), or the Federal Reserve System (Fed)) to avoid costly enforcement. He concentrates his analysis on the most severe types of enforcement actions (i.e., formal written agreement, cease and desist order, prompt corrective action, or deposit insurance threat), which have a direct impact on a bank's activity and risk taking. Examining a sample comprising virtually all commercial and savings banks during the period of intense enforcement around the global financial crisis, he shows evidence that both lobbying status and experience of banks reduced the probability of being targeted by a severe

²⁷ The influence of banks on regulation has not disappeared in the aftermath of the global financial crisis. In another study, Mian, Sufi, and Trebbi (2010) show that constituent and special interests theories also explain voting on key bills in 2008. They examine the effects of constituents, special interests, and ideology on congressional voting on two of the most significant pieces of legislation: the Foreclosure Prevention Act and the Emergency Economic Stabilization Act. Representatives whose constituents experienced a sharp increase in mortgage defaults were more likely to support the Foreclosure Prevention Act, especially in competitive districts. Interestingly, representatives were more sensitive to defaults of their own-party constituents. Special interests in the form of higher campaign contributions from the financial industry was associated with an increase in the likelihood of supporting the Emergency Economic Stabilization Act. However, ideologically conservative representatives were less responsive to both constituent and special interests, potentially reflecting their opposition to bailouts and concern about moral hazard.

enforcement action. According to his estimates, lobbying status reduces the probability of being subject to a severe enforcement action by 44.7 percent, while one additional year of lobbying experience decreases this probability by 11.4 percent. These results are robust to controlling for the CAMELS rating and endogeneity. Consistent with our discussion in Section II on the existence of barriers to entry, he also finds weaker results at the intensive margin of how much banks spend on lobbying once the decision has been undertaken to participate in the lobbying process.

Lambert (2018) also seeks to disentangle two explanations of the result that banks lobby to circumvent costly enforcement actions: regulatory capture versus informational lobbying. To do so, he explores the risk-taking behavior of lobbying banks and their performance, and finds evidence that aggregate risk (as measured by the Z-score) increases at lobbying banks. Further analyses of liquidity and credit risk reveal similar insights: lobbying banks expand more aggressively (on and off the balance sheet) in the years leading to the global financial crisis, and experience an increase in nonperforming loans afterwards. He also finds that lobbying banks have lower performance than other banks and this underperformance persists in the longer run as well as when regulators face greater uncertainty (normally favoring informational lobbying).

Taken together, these findings appear consistent with the theory of regulatory capture. As discussed above, preferential treatment in supervision is viewed as regulators' response to the rent-seeking pressures and political influence of banks (see Panel B of Figure 3). Under this view, captured regulators provide an implicit guarantee to the risk-taking activities of lobbying banks, which is consistent with the results on risk taking documented by Lambert and discussed above. These risk-taking activities are in turn likely to generate distortions in the allocation of resources, translating into poor subsequent performance—and a build-up of risk that may ultimately unwind in a financial crisis. We explore this important consequence in the next section. Lambert's findings on bank performance are in line with this view but not with an information-based view of lobbying.

C. Financial Outcomes: The Case of the Global Financial Crisis

So far, we summarized the evidence on how bank lobbying influences regulatory and supervisory frameworks. Now we turn our attention to the outcomes banks faced during the global financial crisis to close the circle on the potential consequences of regulatory capture.

As demonstrated above, financial regulation became less strict in the run-up to the global financial crisis in part due to the lobbying efforts of the banking industry while banks that lobbied were more likely to avoid enforcement actions. The argument then goes: this lax environment allowed certain banks to engage in riskier lending during the period 2000–2007 and end up with worse outcomes during the crisis. To illustrate with an example, the *Wall Street Journal* on December 31, 2007 reported:²⁸

²⁸ Glenn Simpson, "Lender Lobbying Blitz Abetted Mortgage Mess," *Wall Street Journal*, December 31, 2007.

Working with a husband-and-wife team of Washington lobbyists, [Ameriquest Mortgage Co.] handed out more than \$20 million in political donations and played a big role in persuading legislators in New Jersey and Georgia to relax tough new laws. [...] Ameriquest became a player in the business of lending to low-income homeowners. The company persuaded many homeowners to take cash out of their houses by refinancing them for larger amounts than their existing mortgages. [...] Home loans made by Ameriquest and other subprime lenders are defaulting now in large numbers.

Once the financial crisis hit and the government was forced to intervene, the factors that determined who would be bailed out included, for example, how badly the financial institution was hurt, how systematically important it was, how healthy the balance sheets were, and perhaps how well connected the institution was to the politicians. For instance, the *Wall Street Journal* on January 22, 2009 reported:²⁹

Troubled OneUnited Bank in Boston didn't look much like a candidate for aid from the Treasury Department's bank bailout fund last fall. [...] Nonetheless, in December OneUnited got a \$12 million injection from the Treasury's Troubled Asset Relief Program, or TARP. One apparent factor: the intercession of Rep. Barney Frank, the powerful head of the House Financial Services Committee. [...] Some powerful politicians have used their leverage to try to direct federal millions toward banks in their home states. "It's totally arbitrary," says South Carolina Gov. Mark Sanford. "If you've got the right lobbyist and the right representative connected to Washington or the right ties to Washington, you get the golden tap on the shoulder.

The channels highlighted in such anecdotes suggest that one is likely to observe an empirical association (i) between lobbying and ex ante riskier lending, and (ii) between lobbying and ex post performance as well as the likelihood of bailout in 2008.

These expectations motivate the empirical analysis of outcomes during the crisis conducted in Igan, Mishra, and Tressel (2012). They construct a dataset combining information on banks' lobbying and mortgage lending activities and ask whether lobbying lenders behaved differently from nonlobbying lenders in the 2000–2007 period and how they performed in 2008.

First, the authors look at three measures that capture the ex-ante riskiness of mortgage lending: loan-to-income ratio, proportion of loans sold, and loan growth rates. They find that banks that lobbied more intensively originated mortgages with higher loan-to-income ratios, securitized a faster growing proportion of loans they originated, and had faster growing mortgage loan portfolios.

Then they turn to ex-post performance and find that faster relative growth of mortgage loans by lobbying lenders in the decade prior to the crisis was associated with higher delinquency rates in 2008. The authors also carry out an event study during key episodes of the global

²⁹ Damian Paletta and David Enrich, "Political Interference Seen in Bank Bailout Decisions," *Wall Street Journal*, January 22, 2009.

financial crisis to assess whether the stocks of lobbying lenders performed differently from those of other financial institutions. They show that lobbying lenders experienced negative abnormal stock returns at the time of the failures of Bear Stearns and Lehman Brothers, but positive abnormal returns around the announcement of the bailout program (i.e., TARP). In addition, they analyze the determinants of how bailout funds were distributed and document that being a lobbying lender was associated with a higher probability of being a recipient of these funds.³⁰

Taken together, these findings indicate that lobbying is associated *ex ante* with more risk taking and *ex-post* with worse performance. In other words, some lenders lobbied more aggressively; the ensuing lax regulatory environment let them to engage in riskier lending; and such lending exposed them (directly or indirectly) to worse outcomes during the crisis. In the aftermath, the market anticipated lobbying lenders to benefit more from the bailout, and they indeed did, partly because they had closer connections to policymakers.

Again, there are several possible explanations for these results. Lobbying lenders, for example, may be specialized in catering to riskier borrowers, or they may be overly optimistic and may have honestly underestimated the likelihood of an adverse shock. Then, these lenders may have lobbied to signal their private information to the policymaker and prevent tighter regulation that would otherwise have restricted profitable lending opportunities. If lobbying lenders are specialized or overly optimistic, their motive for lobbying is consistent with an informational view (Panel A of Figure 3). Alternatively, certain lenders may have engaged in rent seeking and lobbied to increase their chances of preferential treatment, for example, a lower probability of scrutiny by regulators or a higher probability of being bailed out (Panel B of Figure 3). Igan, Mishra, and Tressel (2012) do not disentangle these explanations but further document that large lenders were the ones lobbying more aggressively and ultimately getting bailed out with a higher probability. These suggest that lobbying might be conducted with too-big-to-fail issues in mind—consistent with moral hazard elements and rent-seeking explanation.

Igan et al. (2017) look into another aspect of the crisis aftermath: the resolution of failed banks. They explore, using the perspective of lobbying, whether discretion by the FDIC may compromise, or improve, the efficiency of the resolution process. Lobbying can reflect both sides of discretion. On the one hand, the FDIC can receive from lobbying useful private information for its decisions (e.g., on the potential synergies between the target and the acquirer). On the other hand, lobbying may lead to the capture of the FDIC, hindering the resolution actions.

Their analysis utilizes detailed information on failed-bank auctions conducted by the FDIC during the period between 2007 and 2014. They show evidence that bidders lobbying banking regulators are in a better position to win an auction: the probability of winning for them is 26.4

³⁰ Duchin and Sosyura (2012) also investigate the relation between political connections, including lobbying activities, and bailouts under TARP. They find that politically connected firms are more likely to be funded, controlling for other characteristics. Yet investments in politically connected firms underperform those in unconnected firms. They interpret these findings as suggestion that connections between firms and regulators can distort investment efficiency.

percentage points higher while a one-standard-deviation increase in lobbying expenditures targeted on banking regulators leads to an increase in the probability that a bidder wins an auction by 6.6 percentage points. These results hold after controlling for bidder characteristics and target fixed effects, and accounts for endogeneity concerns by using an instrumental variable strategy. Compellingly, the analysis also shows that the usage of revolving-door lobbyists and of lobbying contact with the FDIC have the largest effects on auction outcomes.

Further empirical evidence suggests that rent seeking for preferential treatment accounts for this finding. The authors assess the economic magnitude of the cost associated with the lobbying on failed-bank auctions. To do so, they compare the actual resolution cost to the cost that the FDIC would have incurred if another bid had been chosen and report that lobbying is associated with a smaller cost differential. This indicates that lobbying acquirers pay relatively less than other bidders, resulting in an even more severe drain for the Deposit Insurance Fund (DIF). In particular, they estimate the cost due to lobbying at 16.4 percent of the total resolution losses, amounting to a transfer of \$7.4 billion from the DIF to lobbying bidders. More generally, these findings suggest that the FDIC makes more use of its discretion when bidders lobby. Finally, Igan et al. (2017) show that eventual acquirers with lobbying activities deliver inferior outcomes in terms of post-acquisition efficiency.

This evidence sheds light on the channel through which lobbying affects regulatory outcomes. Under the rent-seeking view, the finding that lobbying banks acquire other banks at lower prices suggests an economic misallocation, as the bank offering the highest price is not necessarily the winner. This comes on top of the DIF's burden of paying larger resolution costs. Of course, consistent with the information channel, regulators may allocate banks at lower prices to bidders who have conveyed private information that convince the regulators that they are in a more favorable position to acquire the failed bank. However, the finding that lobbying banks underperform other acquirers *ex post* appears inconsistent with the efficiency-improving role of bank lobbying. Instead, it is consistent with agency-type inefficiencies in the allocation of failed banks predicted by rent-seeking theories à la Shleifer and Vishny (1994) as in Panel B of Figure 3.

V. LESSONS AND POLICY IMPLICATIONS

The idea that powerful organizations with private interests may capture the government in order to pursue their private benefits is certainly not new. Similar ideas go back at least to Montesquieu and, later, to Marx. But the concept of *regulatory capture*, introduced in modern economic analysis by Stigler (1972), received particular attention in the aftermath of the global financial crisis. In particular, regulatory capture has been blamed by many commentators for the failures and gaps in banking regulation and supervision that led to a buildup of risk ahead of the crisis.³¹ Because of the difficulty in quantifying captured interests, this narrative is mainly anecdotal.

³¹ See, e.g., Stephen Labaton, “Back to Business; Ailing, Banks Still Field Strong Lobby at Capitol.” *New York Times*, June 4, 2009; Ben Hallman, “FDIC Slow to Pursue Failed Bank Directors, Recover Tax Dollars.” *Center for Public Integrity*, March 15, 2011 (updated May 19, 2014).

This paper summarizes recent, systematic evidence on the banking industry capturing the government through its lobbying activities. Specifically, it focuses on financial regulation, supervision, and outcomes during the global financial crisis. Employing detailed data on lobbying available thanks to the LDA of 1995, this line of research shows clear bank-level evidence suggesting that regulatory capture lessens the support for tighter rules and enforcement. A lax regulatory environment is generally understood to allow riskier practices and worse economic outcomes. More generally, from this line of research we gain insights into how the rising and concentrated political power of the banking industry in the first decade of the 2000s propelled the financial system and the “real” economy into crisis.

The appropriate policy response depends on the true motivation for lobbying, which is extremely difficult to pin down empirically, as shown in the studies surveyed. Regulatory capture would suggest that curtailing lobbying is a socially optimal outcome. However, if the banking industry, along with other stakeholders such as consumer protection groups, lobbies to better inform the legislator/regulator, lobbying would remain a socially beneficial channel to facilitate decision-making.

Overall, the findings summarized here are consistent with a regulatory capture view of bank lobbying. While these findings should not be interpreted as evidence in support of an outright ban of lobbying, they clearly point in the direction of a need for rethinking the framework governing interactions between regulators and the industry, including their lobbyists.

Without pretending to provide a complete set of solutions,³² we want to stress two avenues that we think are crucial to contain regulatory capture at more “acceptable” levels, that is, at a level where the benefit of regulation exceeds the cost of regulatory capture. The first avenue is to enhance the transparency of regulatory decisions by mandating the ex-post disclosure of how they are made. The information disclosed (possibly with a delay and perhaps using the regulator’s own web portals) should include the deliberations, minutes of meeting, names of regulatory staff involved, data and models used, number and nature of contacts with registered lobbyists (including their names and the position they advocate on the issue), and an assessment of how the inputs of lobbyists were factored into the final decision. In various circumstances (enforcement action, capital support, resolution), regulators enjoy broad discretion, which is valuable to undertake better informed actions. But, at the same time, regulatory discretion further buttresses the risk of capture. We think that the systematic, ex-post disclosure of information on regulatory decisions would increase regulators’ accountability both toward the general public and toward other (potentially competing) parties. Indeed, this would prevent the reputational cost of defending positions the general public would consider as improper collusion with banks. In this regard, the role of the media is of primary importance as it represents an effective way to overcome the private cost that

³² See, e.g., Baxter (2011, 2012) and Carpenter and Moss (2013).

(continued...)

individuals face in gathering, digesting and analyzing information and, thereby, as it ensures a watchdog role.³³

The second avenue is about placing checks and balances within the decision-making process at regulators. Of course, this starts with setting up properly structured and resourced agencies as well as internal change (of culture and liability rules) within the industry itself,³⁴ but we mean here implementing structures tackling the enduring disproportionate influence of banks and their lobbyists as interest group. As access to influence is asymmetric across interest groups and regulatory power has become more diffuse, the interactions between the regulator and the regulated should be subjected to procedures that ensure the inclusion of dissenting views, that is, views of legitimate groups with different interests, such as customers, smaller financial institutions, and trade unions. Implementing structures of checks and balances involving these less politically powerful interest groups would induce a rebalance of the dominant position currently held by the banking industry. In the spirit of the model of “tripartism” proposed by Ayres and Braithwaite (1991), these interest groups should have lobbying powers and a voice during the deal-making process—namely, having a seat at the negotiation table, having full access to the same information, and standing to take legal action when warranted.

We believe these two avenues should constitute the basis of policy interventions aimed at preventing (or reducing the effects of) regulatory capture in the banking industry. In any case, more research is needed to better apprehend the drivers of capture in its many forms, and also its incidence for both the industry and the society at large. The post-crisis era can provide new insights. For example, the consolidation in the financial sector during that period and the ongoing implementation of new regulations—under the Dodd-Frank Act in particular—see rigorous lobbying activity, with incumbent survivors adopting different strategies by bypassing the Congress.³⁵

³³ For example, in the global financial crisis, when information did leak, it pointed to mistakes made both by large banks and the regulators, helping in turn to produce more informed views on financial regulatory policy (see <https://seekingalpha.com/article/158046>; accessed: August 16, 2017). Although new regulation (Dodd-Frank, Basel III) explicitly stresses increased transparency, this requirement of more information being publicly disclosed is not put forward in the way we propose.

³⁴ See Baxter (2012) for recommendations along these lines.

³⁵ Benjamin Bain, “Here Are Ways Regulators Can Revise Dodd-Frank without Congress,” *Bloomberg*, June 14, 2017.

Appendix: Reporting and Recording of Lobbying Data

In general, the LDA requires registration by any individual lobbyist (or the individual's employer if it employs one or more lobbyists) within 45 days after the individual first makes, or is employed or retained to make, a lobbying contact with either the President, the Vice President, a Member of Congress, or any other specified Federal officer or employee, including certain high-ranking members of the uniformed services.³⁶ Since 1996, all lobbyists (intermediaries who lobby on behalf of companies and organizations) have filed semi-annual reports with the Secretary of the Senate's Office of Public Records (SOPR), listing the name of each client (firm) and the total income they have received from each of them. In parallel, all firms with in-house lobbying departments are required to file similar reports stating the total dollar amount they have spent (either in-house or in payments to external lobbyists).

The LDA requires the disclosure of not only the dollar amounts actually received/spent, but also the issues lobbying activity has targeted. To be more specific, the LDA requires the filer to state the general issue areas on which the registrant engaged in lobbying during the reporting period. There are 76 general issue areas, of which at least one has to be entered by the registrant/filer. The filer can list more than one issue. In that case, she has to use a separate page of the form for each area selected and provide the relevant information on each activity. Specifically, for each general issue, the filer is required to list the specific issues which were lobbied for during the semi-annual period. For example, specific bills before Congress or specific executive branch actions are required to be listed in the form. Thus, unlike PAC contributions, lobbying expenditures of companies can be associated with very specific, targeted policy areas.

The datasets compiled in the studies summarized in this paper are based on the semi-annual lobbying disclosure reports filed with the SOPR and can be compiled from two sources: (i) the SOPR website and (ii) the website of the CRP. The latter provides information on the lobbying expenditures as well as the general issue area (e.g., bankruptcy) with which lobbying is associated. For detailed information including specific issues targeted (e.g., the name and number of the bill introduced in Congress) and executive/legislative offices contacted, one needs to go over the individual PDF reports posted on the former website to extract the desired information.

Lobbying firms (or lobbyists) are required to provide a good-faith estimate rounded to the nearest \$20,000 of all lobbying-related income in each six-month period. Likewise, organizations that hire lobbyists must provide a good-faith estimate rounded to the nearest \$20,000 of all lobbying-related expenditures in a six-month period. An organization or a lobbying firm that spends less than \$10,000 in any six-month period does not have to state its expenditures. In those cases, the CRP treats the figure as zero. Occasionally, income that an

³⁶ Under Section 3(10) of the LDA, an individual is defined as a "lobbyist" with respect to a particular client if he or she makes more than one lobbying contact (i.e., more than one communication to a covered official) and his or her "lobbying activities" constitute at least 20 percent of the individual's time in services for that client over any six-month period. "Lobbying activity" is defined in Section 3(7) of the LDA as "lobbying contacts or efforts in support of such contacts, including background work that is intended, at the time it was performed, for use in contacts, and coordination with the lobbying activities of others."

outside lobbying firm reports receiving from a client is greater than the client's reported lobbying expenditures. Many such discrepancies can be explained due to filer error. In cases not already resolved in previous reports and where the discrepancy exceeds the \$20,000 that can be attributed to rounding, the client's expenditures rather than the lobbying firm's reported income are used. The only exception is when a client reports no lobbying expenditures, while the outside lobbying firm lists an actual payment. In such cases, the figure reported by the lobbying firm is used.

Annual lobbying expenditures and income (of lobbying firms) are calculated by adding mid-year totals and year-end totals. Whenever a lobbying report is amended, income/expense figures from the amendment are generally used instead of those from the original filing. Often, however, CRP staff determines that the income/expenditures on the amendment or termination report are inaccurate. In those instances, figures from the original filing are used.

In cases where the data appear to contain errors, official Senate records are consulted and, when necessary, the CRP contacts SOPR or the lobbying organizations for clarification. The CRP standardizes variations in names of individuals and organizations to clearly identify them and more accurately represent their total lobbying expenditures. In cases where both a parent and its subsidiary organizations lobby or hire lobbyists, the CRP attributes lobbying spending to the parent organization. Therefore, the lobbying totals reported by the CRP for a parent organization may not reflect its original filing with the Senate, but rather the combined expenditures of all related entities. However, to calculate lobbying expenditures by sector and industry, each subsidiary is counted within its own sector and industry, not those of its parent. The CRP makes this distinction when it has the information necessary to distinguish some or all of the subsidiary's lobbying expenditures from either the subsidiary's own filing or from the receipts reported by outside lobbying firms.³⁷ In addition to firms' own lobbying expenditures, lobbying expenditures by associations (such as the American Bankers Association, the Securities Industry and Financial Markets Association, American Council of Life Insurers, National Association of Realtors, etc.) are also filed on the CRP website and included in the sector and industry totals.

³⁷ For example, tobacco giant Altria Group owns Kraft Foods. Although Altria Group's original filing includes lobbying for Kraft in its expenditures, in the dataset the CRP isolates Kraft's payments to outside lobbyists and includes them in "Food Processing and Sales".

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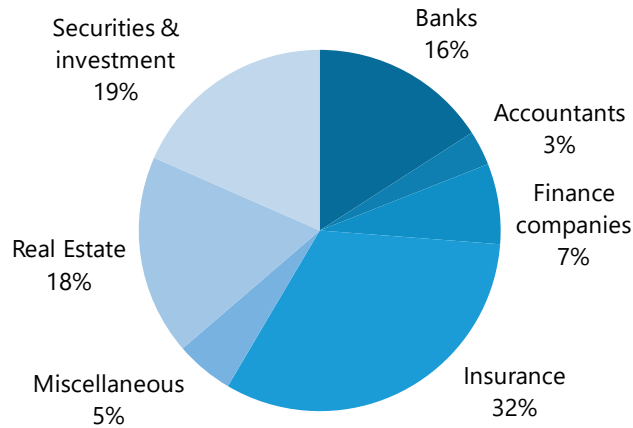
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Figure 1. Lobbying Spending by Financial Industries

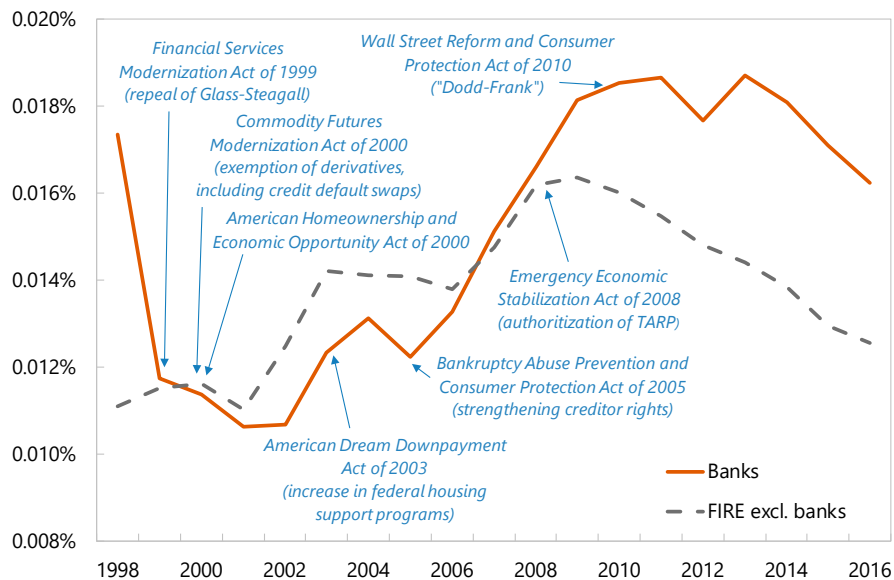
Lobbying Spending by Financial Industries
(percent of total spending by the financial industry in 1998-2016)



Sources: Center for Responsive Politics; authors' calculations.
Note: Miscellaneous mainly include companies providing financial data, consulting, and support services (e.g., Bloomberg LP, Experian).

Figure 2. Lobbying by Banks and Other Financial Industries

Lobbying by Banks and Other Financial Industries
(in percent of industry value added)



Sources: Center for Responsive Politics, Bureau of Economic Analysis; authors' calculations.

Figure 3. Conceptual Framework

