Lobbying for Financial Regulation

- Why did firms lobby on mortgage regulation?
  - Specialized rent-seeking
  - Short-termism
  - Innovation and differences in information

- What does Igan et al tell us about lobbying?

- Implications for policy

Lobbying as rent-seeking

- Firms seek government benefits through lobbying

- Social costs:
  - Misallocation of capital across firms
  - Misallocation of resources (productivity versus rent-seeking) within firms

→ Curtailed lobbying is socially improving

Results of rent-seeking in America

Results of rent-seeking in Turkey

Short-term gain, long-term pain

- Misgovernance and misdirected incentives resulted in real estate Ponzi scheme

- Lax regulation exacerbated bad lending

→ Private and public oversight may be substitutes? Possible multiple policy channels?

Example: Washington Mutual

- “During Mr. Killinger’s tenure, WaMu pressed sales agents to pump out loans while disregarding borrowers’ incomes and assets, according to former employees… between 2001 and 2007, Mr. Killinger received compensation of $88 million”

- In 2007, WaMu spent ~1M for lobbying “on credit card and overdraft practices, information security, bills related to anti-predatory lending and risky mortgages, patent reform,…”

Lobbying and financial innovation

- Model:
  - Firm develops innovation with high – and highly uncertain – expected returns
  - Financial product innovation requires complementary regulatory changes

  → Lobbying for regulatory shift is part of bringing innovation to market

→ Lobbying as information provision

Lobbying and innovation: Extension

- Uncertainty (by policy-maker) over whether firm is rent-seeking or innovation-seeking
- Adjudicates based on probability that “true” purpose is innovation
- Forced to judge based on info from firms

Igan et al – Results

- Lobbying firms had higher LIR

- These results are attenuated in anti-predatory lending states

- *Ex post*, higher default rates by lobbying lenders

Which models do the data rule in/out

- All models are consistent with the data
  - Rent-seeking (with gov’t bailout)
  - ST Incentives (as long as insiders cash out)
  - Innovation and uncertainty (good decision, bad outcome by firm? Good decision, bad outcome by regulator?)

- Distinguishing among the models…

Distinguishing among models?

- Short-term incentives:
  - Did lobbying firms have stronger ST incentives?
  - Note that failing firms *didn't* have worse incentives (Rudiger & Stulz)

- Rent-seeking versus Innovation?
  - Hard to distinguish, since we only observe *ex post* outcomes; hard to know *ex ante* cost-benefit trade-offs

Lobbying on finance, and lobbying in general

- In general, trade-offs between information provision/access and rent-seeking; very hard to distinguish in the data
- Even if this were rent-seeking by financial firms, can we generalize to lobbying overall?