BANKING AND POLITICS IN RUSSIA

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TWO RECENT PAPERS

- “**Political Cycles and Bank Lending in Russia**” (Fungáčová, Schoors, Solanko and Weill) BOFIT Discussion Paper 8/2020
- “**The Politics of Bank Failures in Russia**” (Fungáčová, Karas, Solanko and Weill) BOFIT Discussion Paper (forthcoming)

BANKING AND POLITICS

- increasing interest in studying the interplay between banking and politics
  - the key idea is that politicians might have incentives to interfere in banking in order to
    - increase their chances of re-election
    - reduce potential threat of social instability
- why banking matters for politics
  - bank lending affects economic growth (finance and growth literature)
  - financial stability is important for political survival (bank failures and crises generate economic costs)

ELECTIONS AND BANKING

- literature on political business cycles (Nordhaus,1975)
  - usage of macroeconomic instruments can be influenced by political motives and not just maximizing social welfare
  - this leads to political business cycles
- political business cycle literature focuses on monetary and fiscal policies but governments can also use other tools to gain electoral advantage including the banking industry
  - elections can therefore contribute to banking cycles
  - two main channels through which elections generate banking cycles
    - bank credit
    - bank failures

POLITICAL CYCLES AND BANK LENDING IN RUSSIA

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ELECTIONS AND BANK LENDING

- evidence that political influence is used to expand credit in order to secure votes
  - emerging markets
    - lending by state-owned banks in emerging markets increases in election years relative to private banks (Dinc, 2005)
    - Cole (2009) – credit booms in agricultural credit by Indian government-owned banks in election years
    - Carvalho (2014) - politicians in Brazil use bank lending to shift employment towards politically attractive regions near elections
    - Schoors and Weill (2020) – corporate loans used to incentivize employers to influence voting behaviour of their employees in Russia
    - Bircan and Saka (2021) - state banks in Turkey engage in politically motivated lending around local elections when compared with private banks
  - developed markets
    - Englmaier and Stowasser (2017) - German savings banks adjust lending policies in response to local electoral cycles
    - Delatte, Matray and Pinardon-Touati (2020) – political credit cycle for formally independent French banks with reward in form of bank access to the profitable market of loans to local public entities

ELECTIONS AND BANK LENDING

- existence of electoral credit cycles
  - instruments through which the authorities can influence bank credit
    - state-owned banks which can be easily utilized by government to pursue its own interests (Sapienza, 2004) are shown to serve as a strategic tool for re-election purposes
    - banks where supervisory board chairman is a politician (Englmaier and Stowasser, 2017)
  - economic costs of political interference in lending
    - credit booms do not affect investment or output => not efficient allocation of credit can influence economic growth in the long run
    - worsening financial situation of banks e.g. increase in non-performing loans
- the role of private banks
  - important in electoral autocracies – these regimes are different from democracies where authorities have fewer opportunities to influence elections by pressure on private banks

ELECTIONS IN RUSSIA

- questions on possible interventions in the electoral process in Russia are not new
- interventions to guarantee the electoral outcome are investigated in the literature and different channels are considered
  - media control (Enikolopov, Petrova and Zhuravskaya, 2011)
  - electoral fraud (Klimek et al., 2012)
  - workplace mobilization (Frye, Reuter and Szakonyi, 2014)
  - use of state-owned banks (Schoors and Weill, 2020)

=> indication that authorities tend to have interest in shaping the election outcomes

WHAT DO WE DO

- we study whether banks in Russia increase their lending before presidential elections
  - test the lending behaviour of state-owned banks
- examine if presidential elections are followed by an increase of bad loans
- utilize detailed monthly data on individual Russian banks
  - final sample constitutes unbalanced panel of over 131,000 bank-month observations for over 1,200 banks
- consider the period of 1/2004 - 5/2019 which includes four presidential elections

METHODOLOGY

- estimate the following panel regression for loan growth on a set of variables including elections dummy

$$loangrowth_{i,t} = \alpha + \beta * elections_t + \eta * state_{i,t} + \rho * elections_t * state_{i,t} + \gamma * X_{i,t-1} + \eta * output_{t-2} + \omega_i + \tau_t + \varepsilon_{i,t}$$

- $\boldsymbol{loangrowth_{i,t}}$ month-on-month growth in bank lending
- $\boldsymbol{elections_t}$ dummy variable equal to 1 for the month of elections (March 2004, 2008, 2012, 2018) or for the months before elections
- $\boldsymbol{X_{i,t-1}}$ a matrix of bank-specific control variables (size, capital ratio, bad loans, loans to assets ratio)
- $\boldsymbol{output_t}$ output index for key economic activities
- ω_i and τ_t the bank and time fixed effects

MAIN ESTIMATIONS

Dependent variable: total loan growth (mom)								
Election specification	(1) March	(2) February	(3) January	(4) December	(5) Jan-March	(6) Dec-Feb	(7) Oct-March	(8) Sept-Feb
Elections	0.009*** (0.003)	0.006** (0.003)	-0.003 (0.003)	0.023*** (0.003)	0.005*** (0.001)	0.009*** (0.002)	0.009*** (0.001)	0.010*** (0.001)
State-owned	-0.000 (0.005)	0.000 (0.005)	-0.001 (0.005)	-0.000 (0.005)	-0.001 (0.005)	-0.001 (0.005)	-0.000 (0.005)	-0.000 (0.005)
Elections×State-owned	-0.005 (0.008)	0.006 (0.008)	0.036*** (0.012)	-0.012 (0.012)	0.011** (0.005)	0.010* (0.006)	0.003 (0.004)	0.005 (0.004)
Control variables	YES	YES	YES	YES	YES	YES	YES	YES
Bank & time effects	YES	YES	YES	YES	YES	YES	YES	YES
Observations	131,116	131,116	131,116	131,116	131,116	131,116	131,116	131,116
Number of banks	1,209	1,209	1,209	1,209	1,209	1,209	1,209	1,209
R2-within	0.0276	0.0275	0.0276	0.0280	0.0276	0.0278	0.0280	0.0280

- lending of all banks increases before elections => interplay of politics and banking in electoral autocracy
- state-owned banks not different from others (not in line with previous literature)

BAD LOAN GROWTH AFTER ELECTIONS

- if the increase of lending before elections was driven by economic factors, there would be no reason for a rise in bad loans after the elections
- check if elections are followed by an increase of bad (overdue) loans one year after the elections
- post-election increase of bad loans would indicate that pre-election increase of lending was the consequence of political interference

BAD LOAN GROWTH AFTER ELECTIONS

Dependent variable	Bad loan growth (year-on-year)	Overdue loan growth (year-on-year)
Elections	0.451***	0.395**
	(0.088)	(0.167)
Elections×State-owned	-0.109	-0.742*
	(0.248)	(0.435)
State-owned	-0.345***	-0.070
	(0.128)	(0.413)
Size	0.016	0.011
	(0.021)	(0.046)
Capital/assets	-0.223	-0.548
	(0.300)	(0.765)
Loans/assets	0.517**	1.900***
	(0.229)	(0.477)
Output index	0.166***	0.383***
	(0.029)	(0.052)
Constant	0.403	0.531
	(0.348)	(0.826)
Observations	10,256	9,649
Number of banks	1,118	1,087
R2-within	0.0175	0.0142

- significant increase of bad loans following the elections for all banks
- no specific increase of bad loans for state-owned banks after elections

IS THE PRE-ELECTION INCREASE FOCUSED ON CERTAIN TYPE OF LENDING OR BANKS?

- lending increases before elections for both firm and household loans
- higher loan growth before elections is observed particularly for banks that are most involved in lending
  - bigger banks
  - banks with higher loans/assets ratio
- lending behaviour of banks with weak fundamentals before elections does not differ from other banks
  - banks with weak fundamentals do not increase lending to be rewarded by a higher probability to keep the bank's license => they do not buy implicit protection

MAIN FINDINGS

- all Russian banks tend to lend more before presidential elections
- increase in lending is not associated with economic expansion (i.e. increase in demand for loans)
  - we control for economic output / federal expenditure
  - this surge in loans is followed by higher bad loans in the subsequent year
- increase for different types of banks and loans supports political motives
  - lending increases for both firm and household loans
  - increase is higher for larger banks and for banks the most involved in the lending activity
  - increase is not related to weak fundamentals

  => we do not find any economic rationale for increased lending before elections => possibly influenced by political motivations

CONCLUSION

- our work contributes to understanding the interplay between politics and banking in a nondemocratic regime
    - it is not restricted to the influence on state-owned banks but also affects private banks
- further research on similar regimes is necessary to establish the mechanisms and economic structures shaping political lending cycles in non-democracies

ELECTIONS AND BANKING

- literature on political business cycles (Nordhaus,1975)
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- political business cycle literature focuses on monetary and fiscal policies but governments can also use other tools to gain electoral advantage including the banking industry
  - elections can therefore contribute to banking cycles
  - two main channels through which elections generate banking cycles
    - bank credit
    - bank failures

THE POLITICS OF BANK FAILURES IN RUSSIA

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INTRODUCTION

- bank failures might be negatively perceived by the voters
  - political costs of bank failures (e.g. negative signal of the skills of government)
  - negative impact of bank failures on credit supply

=> governments have incentives to have less failures before elections

- less bank closures before elections in emerging countries (Brown and Dinc, 2005) and US (Liu and Ngo, 2014)

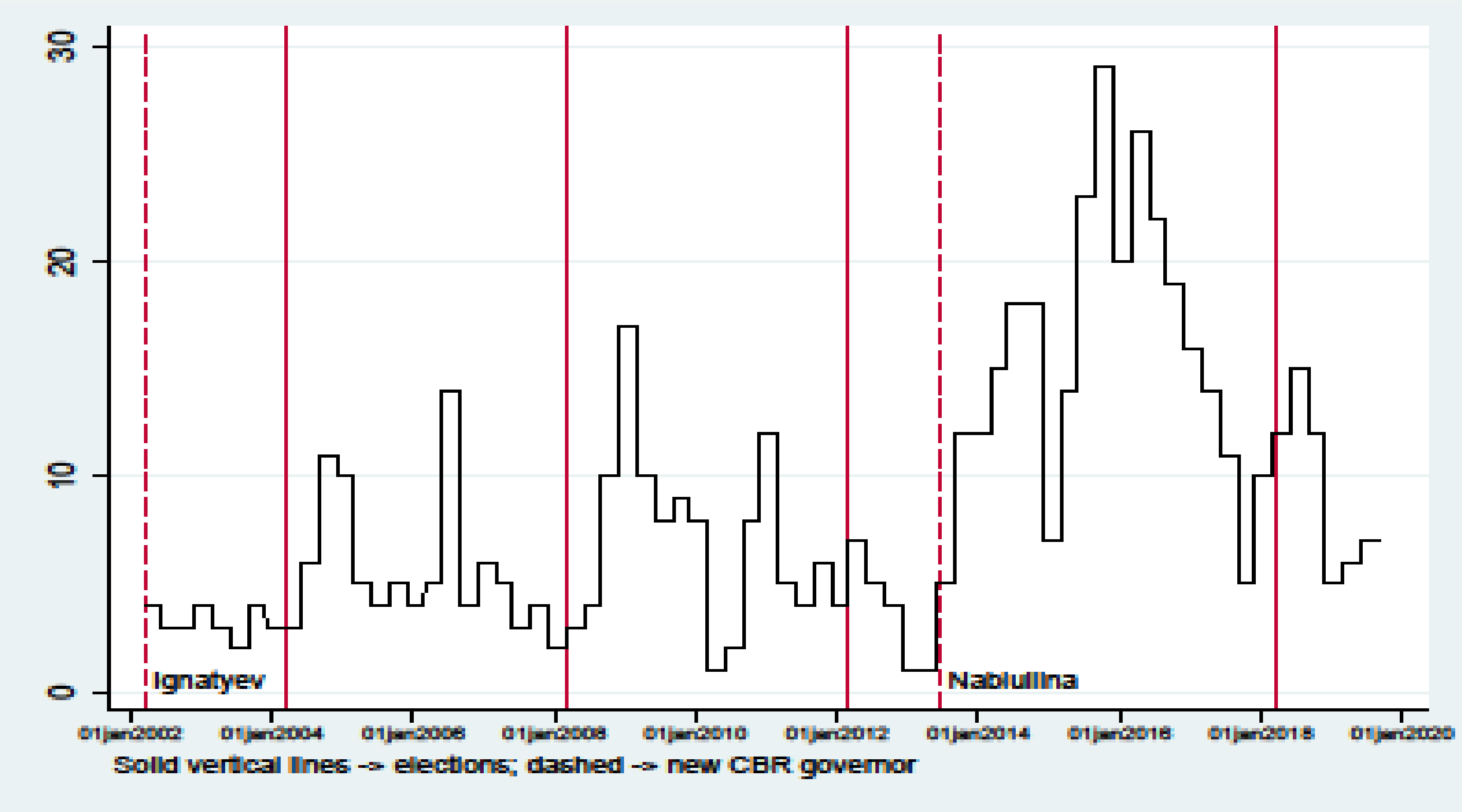
WHAT DO WE DO

- examine if bank failure probability decreases in the months preceding the presidential elections
  - use a logit model to explain the occurrence of failure at the bank level
    - when bank-level and macroeconomic variables are controlled for, no statistical relationship between the electoral cycle and bank license withdrawals should exist - unless politics influences

WHY RUSSIA?

- Russia provides a good case for studying bank failures
  - large number of bank failures (license withdrawals) in the last two decades
    - we focus on years 2002 – 2020 which include four presidential elections (2004, 2008, 2012, 2018)
  - daily data on bank license withdrawals from CBR
    - CBR issues an official communication explaining the reasons of closure
    - classification of reasons for bank closure from Karas (2020): financial health and illegal activities
- final data sample that we use is unbalanced panel of over 192 000 bank-month observations for over 1400 banks
  - about 700 bank failures

BANK FAILURES AND PRESIDENTIAL ELECTIONS



Note: The figure shows number of failures by periods of 3 months (i.e. Dec-Feb 2004, Mar-May 2004, Jun-Aug 2004, etc.).

METHODOLOGY

we estimate the following logit regression

$$failure_{i,t} = \alpha_i + \beta * election_t + \gamma * bank\ controls_{i,t-1} + \eta * macro\ controls_t + \varepsilon_{i,t}$$

- ***failure$_{i,t}$*** dummy variable equal to 1 for the month when the bank license was withdrawn
- ***election$_t$*** dummy variable equal to 1 for certain number of months before elections
  - we consider four different time windows (1,3, 6 and 12 months before elections)
- ***bank controls$_{i,t-1}$*** a matrix of bank-specific control variables (size, capital ratio, non-performing loans, liquidity ratio, ROA)
- ***macro controls$_t$*** a matrix of macro variables defined as changes (industrial production, ruble USD exchange rate, interbank rate)
- $\varepsilon_{i,t}$ error term
- control for seasonality; standard errors clustered at the bank level

MAIN ESTIMATIONS

	[-360;0]	[-179;0]	[-89;0]	[-30;0]
Election	**-0.51*** **	**-0.52*** **	**-0.50** **	**-1.21** **
	(0.11)	**(0.16)**	**(0.25)**	**(0.48)**
Size	-0.25***	-0.24***	-0.24***	-0.24***
	(0.026)	(0.026)	(0.026)	(0.026)
Capital ratio	-1.66***	-1.64***	-1.64***	-1.64***
	(0.33)	(0.32)	(0.32)	(0.32)
NPL ratio	1.87***	1.86***	1.86***	1.85***
	(0.26)	(0.26)	(0.26)	(0.26)
ROA	-81.7***	-82.0***	-82.2***	-82.2***
	(4.26)	(4.26)	(4.25)	(4.25)
Liquid/total assets	-2.39***	-2.37***	-2.37***	-2.36***
	(0.46)	(0.46)	(0.46)	(0.45)
Macro controls	YES	YES	YES	YES
Observations	192,528	192,528	192,528	192,528
# Failures	705	705	705	705
# Banks	1417	1417	1417	1417
Pseudo R2	0.11	0.11	0.11	0.11
AUR	0.72	0.71	0.71	0.71
Pr(Fail): Elect=0	0.0040	0.0038	0.0037	0.0037
Pr(Fail): Elect=1	0.0024	0.0023	0.0023	0.0011

- *Election* is significantly negative => bank failures are less likely in the months leading up to a presidential election

PRE-PUTIN vs PUTIN ERA

- estimations without bank specific variables for the period 1991-2020
- *Election* is significantly negative for estimations in Putin era but positive in pre-Putin era => delaying bank failures before elections has increased since 2002

EXPLAINING THE NUMBER OF FAILURES

- losing bank-level information but running regressions explaining the number of bank failures on a daily basis
- *Election dummy* is significantly negative in all estimations

WHAT HAPPENS AFTER ELECTIONS?

1. reduction of bank failures before elections can lead to more bank failures following the elections
2. occurrence of bank failures can still be lower than in normal times because the whole period surrounding the elections can be influenced

- we redefine election dummy using number of days after elections [0,30], [0,89], [0,182], and [0,364]

=> no significant results => no catching-up taking place after the elections

CONCLUSION

- we provide evidence on the existence of political cycles in bank failures in Russia
  - we do not assume that authorities would directly steer the CBR decisions on license withdrawal around presidential elections as there is always a fair amount of discretion in license revocation decisions
- additional support for the existence of political cycles is provided by auxiliary regressions using longer time periods

SUMMARY

- both of the channels through which elections generate banking cycles are observed in Russia
  1. bank credit – state-owned as well as private banks tend to lend more before presidential elections
  2. bank failures - bank license withdrawals are less likely in the months leading up to a presidential election

THANK YOU

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